Government of the Republic of Slovenia

Stability Programme

2019

April 2019

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1. INTRODUCTION and GENERAL ECONOMIC STRATEGY

Status of the Stability Programme (SP)

The Stability Programme 2019 (draft of 8 April 2019) has been prepared in parallel with the Ordinance on the Framework for the Preparation of Budgets 2020-2022 (hereinafter: the Framework), which is in accordance with the Fiscal Rule Act (hereinafter: FRA). The Framework, pursuant to that law, sets out the target balance and the maximum general government expenditure for the individual financial years and the target balances and maximum expenditure for the individual public finance budgets for the next three years, i.e. 2020, 2021 and 2022. The Framework for the Preparation of Budgets 2020-2022 is a medium-term plan of fiscal projections by the Government of the Republic of Slovenia, which is based on the 2019 Spring Forecast of Economic Trends (IMAD, March 2019), an assessment of the realisation of the individual public finance budgets and units within the government sector in the current year and the planned measures, usually adopted through laws, designed to achieve the medium-term fiscal objective.

Link to Stability and Growth Pact (SGP) and Fiscal Rule Act

The Stability Programme must include a multiannual macroeconomic and fiscal framework, key fiscal projections, their components, and the quantification of budget objectives pursuant to Council Regulation (EC) No 1466/97 (hereinafter: the Regulation) and the Code of Conduct of the Stability and Growth Pact. In accordance with the European Semester, the Republic of Slovenia must submit its Stability Programme for the next three years, including 2022, by the end of April 2019. The European Commission (hereinafter: EC) will then evaluate the Stability Programme by assessing the compliance of the objectives and content with the achieving of the adjustment path to the medium-term fiscal objective (MTO) and, if necessary, request the Member State to strengthen or adjust its Stability Programme if the minimum required efforts are not achieved.

Since the Stability and Growth Pact is based on the objective of sound public finances as a means for improving the conditions for price stability and for strong and sustainable growth that promotes job creation, the Member States endeavour to meet medium-term objectives i.e. to avoid excessive government deficits. The purpose is to achieve improved surveillance of the budgetary position and the surveillance and harmonisation of economic policies particularly with regard to the medium-term objective, and therefore the aim is the achieving of a close to balance or in surplus position, which all Member States have committed to, and the adoption of appropriate corrective budgetary measures which in their opinion are necessary to meet the objectives in the stability and convergence programmes every time there is information about an actual or expected deviation from the medium-term budgetary objective (MTO). The MTO is the central element of the preventive arm of the SGP, pursuant to the Regulation, since it allows the achieving of a close to balance or in surplus position, and thereby allows the management of normal cycical movements and at the same time to keep the government deficit within 3% of the reference value of the GDP. It is very clear in these terms: “These country-specific MTOs may diverge from the requirement of a close to balance or in surplus position, while providing a safety margin with respect to the 3% of GDP deficit limit. The medium-term budgetary objectives pursue the aim of sustainability or rapid progress towards sustainability, while allowing room for budgetary manoeuvre, in particular taking into account the needs for public investment." Taking these factors into account, the specific medium-term objectives for each Member State are set over a range of between -1% of GDP and a balanced cyclically adjusted budget or a cyclically adjusted budgetary surplus net of one-off and temporary measures. The medium-term budgetary objective is revised every three years, or more often in the event of the implementation of a structural reform with a major impact on the sustainability of public finances. The Regulation further states that the MTO shall be revised every three years following the publication of the Ageing Report.[1]

The 2019 review indicated that the minimum MTO for Slovenia was changed over this medium-term period. Thus Slovenia must achieve a general government structural balance of minus 0.25% of GDP by 2022, and not the current plus 0.25% of GDP. In doing so, we have to provide a set of economic policies that allows us to remain at the level of this medium-term objective and not threaten economic growth. Unlike the SGP, the fiscal rule set out in the FRA does not employ the concept of "adjustments towards the MTO", so that economic growth is not threatened, i.e. so that in order to ensure spending rights, public expenditure, e.g. on investments (including in connection with the municipalities or EU funds) can exceed the upper limit of permissible expenditure as set out in the Framework. Furthermore, irrespective of the required matrix of fiscal efforts (which is prejudiced exclusively by the calculation of the output gap, which has been shown to be highly volatile and improperly measured in all theoretical discussions and empirical calculations), the explanation of the fiscal rule was never ambiguous from the perspective of the period of adjustment towards the MTO, but assumes that a fiscal balance will be achieved as early as 2020. Similarly, the national rule does not define the appropriate manner of the annual measurement of required fiscal efforts or adjustment path to achieve the MTO (the so-called half-adjustment path for the required fiscal effort). Namely, according to the interpretation of the Fiscal Council, national rule requires that it remain at the MTO in each case and that it may not deviate, although it will revert back in some "defined time" nor deviate from MTO regardless of the actual state of the economy (deviations are only allowed in exceptional circumstances and during recessions, if they are identified in time, due to difficulties in the ex post assessment or revision of the rate of economic growth or the aforementioned output gap volatility). The national rule thus does not set out an intermediate path where the structural balance would be used merely as a reference. Including an analysis of expenditure net of discretionary revenue measures, we are unable to mathematically appropriately monitor the deviations from the MTO or from the appropriate adjustment path towards it, as permitted by EU rules. For example, "for a Member State that has not reached its medium-term objective, when assessing the change to the structural balance the deviation will be considered significant if it is at least 0.5% of GDP in one single year or at least 0.25% of GDP on average per year in two consecutive years" or "the deviation in output is not considered significant if the Member State overachieved the medium-term objective unless significant revenue windfalls are assessed and if the budget plans set out in the stability programme do not jeopardise the objective over the programme period."

[1] https://ec.europa.eu/info/publications/economy-finance/2018-ageing-report-economic-and-budgetary-projections-eu-member-states-2016-2070_en.

The stability programme shall be based on the most likely macro-fiscal scenario or on a more prudent scenario. The macroeconomic and budgetary forecasts shall be compared with the most updated Commission forecasts and, if appropriate, those of other independent bodies (IMAD forecasts are always used for projections in accordance with the Public Finance Act). The content of the Stability Programme and the National Reform Programme are complementary and overlap. The Stability Programme focuses on macroeconomic development, fiscal policy and public finances, while the National Reform Programme sets out measures, anticipate structural reforms within the contest of the European Semester, and the achieving of the EU 2020 objectives.

Economic outlook

According to the Statistical Office of the Republic of Slovenia (hereinafter: SORS; 19 April 2019) for year 2018 the favourable fiscal trends are continuing, as the government generated a surplus amounting to 0.7% of GDP and reduced the debt to 70.1% of GDP. The 2019 Spring Forecast of Economic Trends (hereinafter: the spring forecast) prepared by the Institute of Macroeconomic Analysis and Development (IMAD) in March 2019 for 2019 and the following two years, envisages the continued gradual slowing of economic growth. The spring forecast indicates that upon the slowing of the boom in the international business environment, real GDP growth will be 3.4% in 2019, 3.1% in 2020 and 2.8% in 2021. The change in the structure of economic growth that began last year is expected to continue in the direction of an increased share from domestic consumption and a lower share from exports. The still-high growth in investments is expected to slow slightly. The slowing of economic growth is expected to occur slightly faster than forecast last year, primarily due to less favourable trends in the international environment. Employment is expected to continue to grow in the forecast period, while wage growth is expected to increase primarily this year and somewhat also in the next two years.

Table 1: Key economic and fiscal variables

	2017	2018	2019	2020	2021	2022
Economic activity						
GDP growth (in %)	4.9	4.5	3.4	3.1	2.8	2.7
Prices						
GDP deflator	101.6	102.3	102.7	102.5	102.6	102.4
Average annual price increase	1.4	1.7	1.6	1.9	2.2	2.2
Labour market						
Employment according to national accounts (in thousands)	989	1.017	1.038	1.048	1.055	1.059
Employment rate (20–64 yrs, in %)	73.4	75.5	76.9	77.8	78.6	79.3
Unemployment rate according to ADS (in %)	6.6	5.1	4.3	3.9	3.7	3.4
Public finances						
General government balance	0.0	0.7	0.9	1.0	1.1	1.2
Structural balance	0.2	0.0	–0.1	–0.2	–0.1	0.1
Debt (end of year)	74.1	70.1	65.4	61.3	57.9	54.7

Source: IMAD, SORS, Ministry of Finance

The Government of the Republic of Slovenia already during the preparation of the supplementary budget for 2019 maintained a path such that according to the estimate of the

Ministry of Finance the general government structural balance will be balanced by the end of 2022, whereby we will already have reached our medium-term objective (MTO) in 2020. However, the early elections (in June 2018) limited the government's room for manoeuvre for 2019, and therefore from the perspective of the functioning of fiscal policy it was crucial that the supplementary budget was adopted with all of the already implemented measures in 2018 and that the government addressed the medium-term challenges. Here it should be noted that the regulation of debt is the basic guideline for the formation of economic policy, whereby Slovenia will endeavour to maintain a nominal general government surplus (thereby providing for long-term fiscal sustainability in the medium term). If the debt rule were not the basic guideline for the formation of economic policy, it would not be possible to provide an appropriate range of economic policies or ensure an adequate level of economic growth. Slovenia has on several occasions drawn the attention of both the European Commission and the general public to the inadequacy of pursuing the achievement of solely annual (mathematically calculated) targets, as this type of behaviour can have irreparable consequences on the economy, i.e. threaten economic growth during periods of stabilisation or cooling of the cycle.

Productivity and higher added value at a level that would allow us to catch up more quickly to the level of developed countries and improve our standard of living are the key objectives of Slovenia's future economic policy. Productivity is the most important factor of economic growth, taking account of the challenges associated with demographic and environmental changes. This has effect on the quality and long-term sustainability of public finances and on the long-term growth of the potential GDP. To this end, stimulus must be given to those structural factors that are key to productivity growth in the short and longer term. These are associated primarily with human resources, a competitive, research-and-development oriented and innovative environment, and general institutional efficiency. The aim of the proposed tax changes, which are based on the rebalancing of tax burdens between income from work and income from capital, is to encourage greater competitiveness by lessening the employee tax burden, which will have a positive impact on sustainable economic growth.

The proposed structural changes to the labour market address issues relating to human resources, demographics, the sustainability of the pension system and the adequacy of pensions. This will have a positive effect on the employment of older people, improve the social protection for certain vulnerable groups and result in the faster activation of the population. The proposed changes to the pension system include an increase in the assessment rate and thereby the adequacy of new old-age pensions, an increase in the pension age and a gradual increase on the age limits for retirement, an overhaul of the system for simultaneous receiving of pensions while working, and studying the method for adjustments to pensions. In the area of the regulation of the labour market, the most important measures involve increasing the minimum level of unemployment compensation and shortening the maximum period for receiving unemployment compensation. At the same time, we will continue to implement measures for a more effective active employment policy and social activation.

Here it should be clear that lasting reforms and the overcoming of past development backlogs cannot be a part of the annual budget cycle. It is worth noting that since the adoption of the Stability and Growth Pact (SGP) and the European economic governance package (Six Pack + Two Pack), Slovenia has not been entitled to even a single flexibility clause for withdrawal from the MTO (neither structural nor for investment), which once again demonstrates that the specifics of small open countries are not being taken into consideration, i.e. that the deadlines for fiscal consolidation are hard to meet from the perspective of the political cycle, which generally does not coincide with the economic cycle.

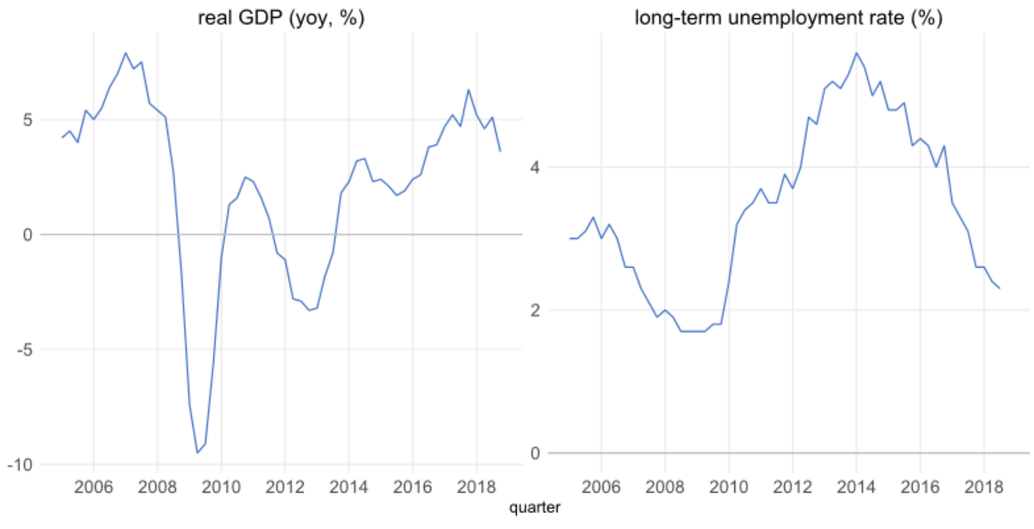
2. MACROECONOMIC OUTLOOK

2.1. Macroeconomic developments 2018-2019

Slovenia's high real economic growth rate (4.5%) continued in 2018. The largest share was contributed by gross fixed capital formation and increased domestic consumption. Household consumption was relatively high, while growth in private consumption remained moderate despite a large rise in employment and increases in wages and social transfers. Growth in exports began to slow last year mainlydue to lower growth in economic activity in Slovenia's main trading partners. Consequently, in 2018 economic growth was 4.5%, which is slightly lower compared to 2017 (4.9%). With the continued gradual slowing of economic growth, the forecast for 2019 predicts 3.4% growth which has remained higher than the EU and the euro area average since 2015.

After a noticeable increase in 2017, growth in formal employment remained high in 2018 (3.2%), while the number of employed people is at its highest point to date (872,000 formally employed in 2018). This was mainly a consequence of the employment of foreign nationals and the inclusion on the labour market of people who previously have not been seeking employment. The decrease in the number of registered unemployed people thus continued in 2018 (8.2%) and is expected to do decrease again in 2019 (7.6%). The surveyed unemployment rate in 2019 will also be 0.8 percentage points below the 2018 level, at 4.3%. The long-term unemployment rate is also decreasing, and is at its lowest level since 2010, but is still higher than the pre-crisis level. More than a third of the long-term unemployed represent people aged over 50 years.

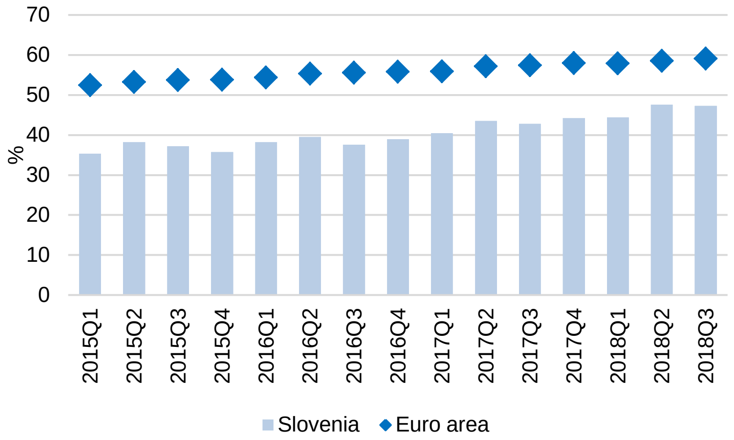
Figure 1: Movement in the growth of real GDP and rate of long-term unemployment, 2005-2018



Source: Eurostat, MF calculations

The employment rate of older workers (age 55-64) is increasing noticeably. It rose by 12 percentage points from the first quarter of 2015 to the third quarter of 2018 (most recent available data). The increase is above all due to favourable economic trends, the high level of employment and the recent pension reform in 2013. After the reform the inflow of new pensioners dropped significantly; the average age upon retirement is increasing, as is the pensionable service period. Nevertheless, the employment rate of older workers (age 55-64) is lower than the average for the euro area, and therefore employment policies and lifelong learning are being focused on this demographic.

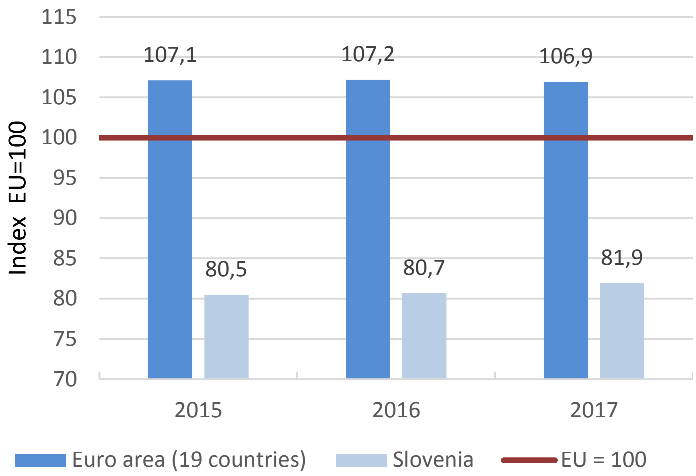
Figure 2: Employment rate of workers aged 55-64 in Slovenia and the euro area



Source: Eurostat

The high economic growth in recent years has been driven above all by a significant increase in employment, in contrast to the pre-crisis period, when labour productivity was the primary driver of economic growth. That is, for decades, economic growth was based on technological structures designed around medium-skilled labour, with limited possibilities for the generation of higher GDP per employee. Economic policy therefore cannot be aimed solely at supporting the existing economy, but must play an active role in its restructuring towards activities with higher added value (Bank of Slovenia, 2018). Despite a rise in productivity growth, primarily on account of improved allocation of production factors, increased inflows of foreign direct investment and lower corporate debt, the level of productivity is still lower than both the EU and the euro area average.

Figure 3: Productivity in purchasing power parity

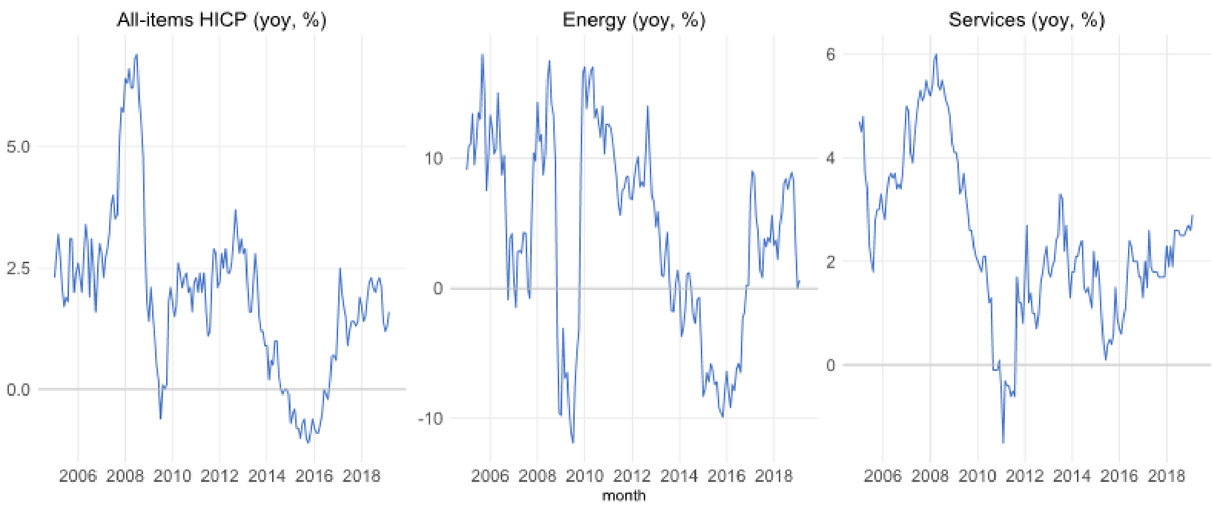


Source: Eurostat

After several years of modest growth, wage growth in 2018 increased in nominal terms both in the private (4.0%) and the public sector (3.0%). The growth in the private sector was above all the consequence of positive corporate earnings and a lack of qualified workers, and in the public sector due to the adoption of an agreement with the trade unions and high wage growth in public companies. Despite the increase in overall wage growth in 2018 it did not exceed the productivity level. Wage growth will continue to strengthen in 2019 (IMAD, spring forecast 2019).

The inflation rate in 2018 was a relatively low 1.7%, which is otherwise the highest inflation rate since 2013 (1.8%). The primary reasons are high growth of services prices and high fuel prices. Inflation will remain moderate in 2019 (1.6%) along with increased growth in the prices of services and non-energy industrial goods, and assuming lower oil prices.

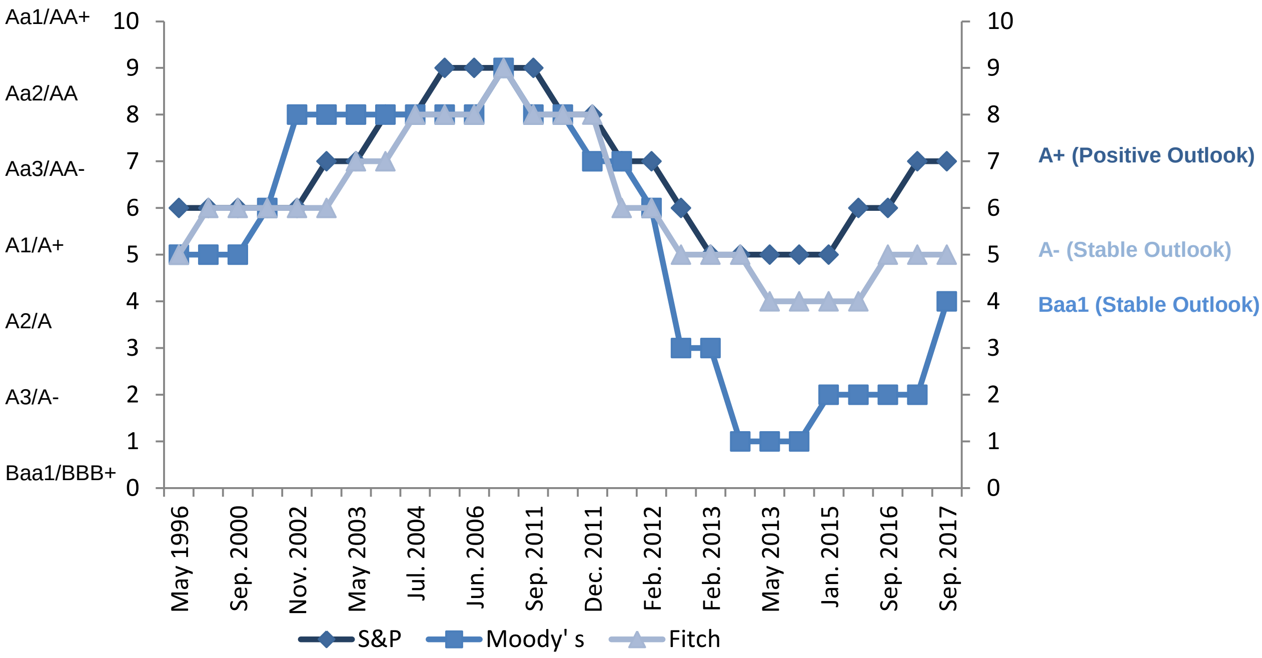
Figure 4: Inflation developments in the period from 2005 to 2018



Source: Eurostat, MF calculations

The macroeconomic position is also dependent on the assessments of credit risk and credit spread risk. In the second half of 2011 the rating for the Republic of Slovenia has begun to drop due to poor performance in areas of economic growth, the banking sector and stagnation of systematic reforms. The negative trend continued and bottomed out in 2013. A positive trend of improved ratings started in 2015 and in 2017 reaching levels A+ (S&P), A- (Fitch) and Baa1 (Moody's).

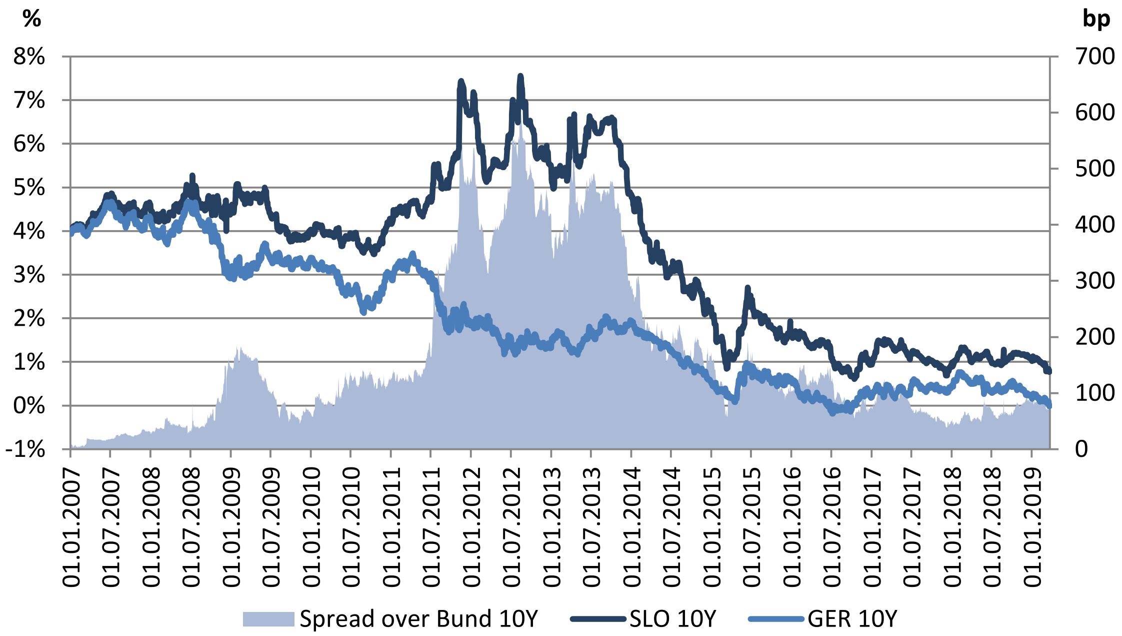
Figure 5: Republic of Slovenia Credit Rating over Time



Source: S&P, Moody‘s and Fitch, 27.3.2019

The figure below shows that in the years 2007 and 2008 the 10-year bid yield of Republic of Slovenia and Bunds were relatively correlated. During the crisis the yields started to diverge with peak spread above 600 bp. In 2014 the spread over Bund declined sharply and the yields started to correlate again at much closer levels. On 25th March 2019 the 10-year spread over Bund amounts to 78,7 bp.

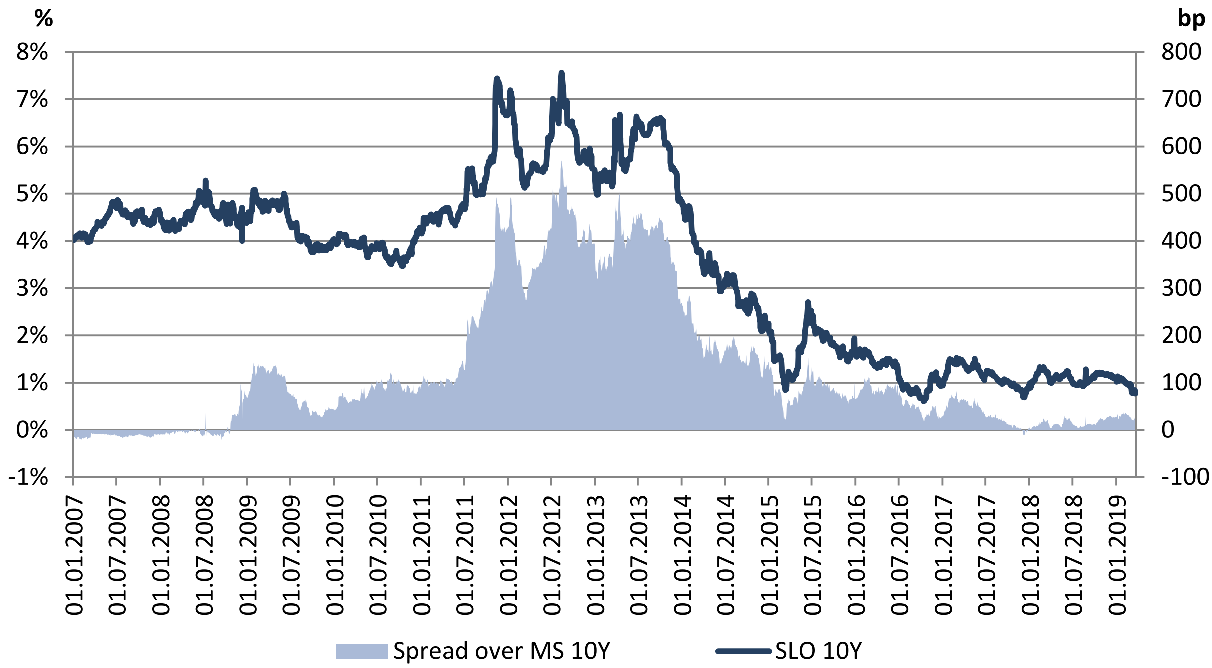
Figure 5: 10-year Euro Yield Dynamics of Republic of Slovenia in Comparison to Germany



Source: Bloomberg, MF interpolation (SLO), 27.3.2019

As it is shown in the figure below in the crisis period, precisely in the year 2012, the yield in the secondary market crossed the 7% mark for the first time and the credit spread at that time, i.e. the spread over 10-year mid swap represented 75% of the yield. On 25th of March 2019 the credit spread represents the minority share, i.e. 35%.

Figure 6: 10-year Yield Dynamics of Republic of Slovenia and Spread over 10-year EUR Mid Swap

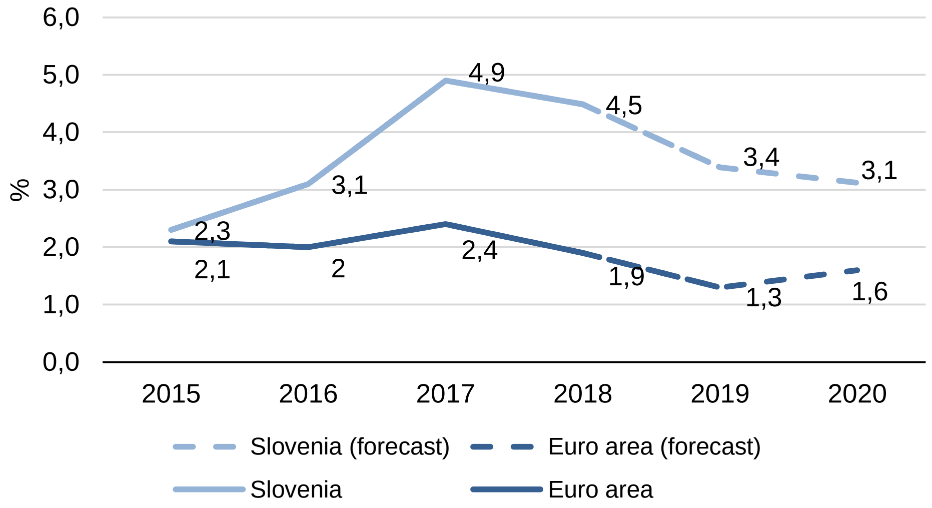


Source: Bloomberg, MF interpolation (SLO), 27.3.2019

2.2. Medium-term forecast 2020-2022

According to IMAD's macroeconomic forecasts, a continued gradual slowing of economic growth is expected in the medium-term to 2022, but will remain higher than growth in the euro area. Upon the slowing of the boom in the international business environment, real GDP growth is expected to be 3.1% in 2020, and 2.8% and 2.7% in 2021 and 2022 respectively.

Figure 7: Real GDP growth in Slovenia and the euro area and growth forecast to 2020



Source: Eurostat, UMAR, spring forecast 2019, European Economic Forecast, 2019

Risks and the IMAD spring forecast

The risks to achieving the spring forecast, due to which economic growth could be outside the forecast in the main scenario, include above all negative risks in the international environment. In conditions of significant uncertainty, the risks of lower economic growth than that forecast in the main scenario are associated with risks in the global and European economic areas, which have slightly increased in the last few months. The primary global risks are: i) the possibility of USA's increased protectionism and retaliatory measures by its trading partners,[2] ii) more pronounced slowing of economic growth in China than that forecast by international institutions, and iii) more rapid tightening of global financing conditions than expected. In Europe, risks are associated with uncertainty regarding the time and manner of the United Kingdom's withdrawal from the EU and its future economic relations (risk of an uncontrolled or hard Brexit),[3] the economic policies of certain countries (e.g. Italy), and also with political

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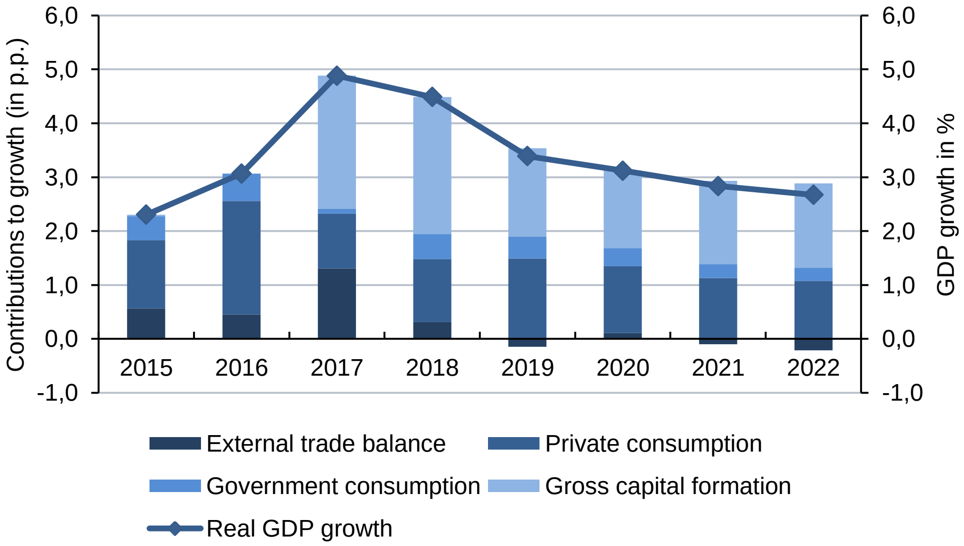
[2] Some of our largest trading partners (particularly Germany) would be directly affected particularly by any increases in US customs duties on imports of cars and car parts, which would also have a direct negative impact on economic activity in Slovenia (see the 2018 Autumn Forecast of Economic Trends, Box 3). The escalation of a trade war between the US and China would also have a negative impact on the economic growth of both Slovenia and its trading partners.

[3] Various studies of the long-term impact of a soft Brexit estimate it at from 0.0% to -0.25% of GDP, while the impact of a hard Brexit would be from -0.2% to -1.0% of GDP. The short-term effects, which are more difficult to measure, could be more pronounced due to the adaptation of the operations of value chains (see the 2019 Spring Forecast of Economic Trends).

changes, particularly in the medium term.[4] The short-term factors in the domestic environment are mainly positive and could result in slightly higher economic growth than forecast in the main scenario due to new, at the time of the forecast not yet adopted economic policy measures that would result in increased private consumption, and growth could also be higher due to increased government investment.

The change in the structure of economic growth that began in 2018 will continue in the coming years in the direction of an increased share from domestic consumption and a lower share from exports. Export growth will continue to decline, primarily due to the slowing of economic growth among Slovenia's trade partners. Growth in private consumption will slightly increase this year with continued favourable conditions on the labour market, and will then gradually slow in parallel with slowed growth in employment. The still high level of growth in investments will also decline slightly, primarily in the machinery and equipment segment, as a consequence of declining growth in foreign demand. The high level of growth in construction investments will continue, in part due to increased draw-down of European funds. Since the slowdown in the growth of imports will be slightly less marked (due to robust domestic consumption), the share of foreign exchange in GDP growth will be slightly negative. The slowing of economic growth will occur slightly faster than forecast last year, primarily due to less favourable trends in the international environment.

Figure 8: Contributions to GDP growth

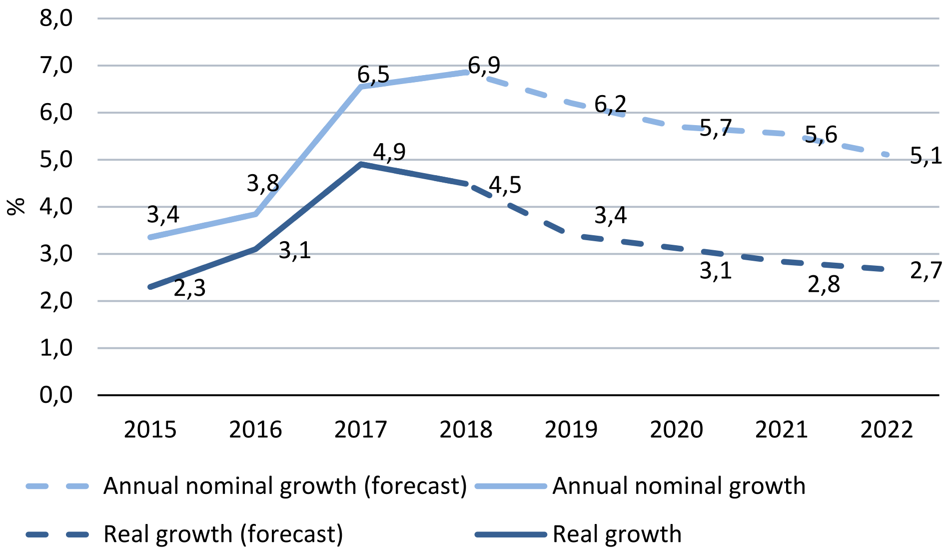


Source: IMAD, spring forecast 2019

The gradual increase in price pressures will affect the inflation, which will increase slightly over the next two years (around 2%). In the coming years we are expecting a more pronounced increase in the growth of prices in the services segment, and in the prices of non-energy industrial goods. The difference between nominal and real GDP growth increased in 2018, and this is expected to be maintained in the medium term till 2022.

[4] Political changes in certain countries could have a more pronounced effect on economic policy orientations, the results of which could be transferred to the entire euro area or EU. The significant rise in the influence of Eurosceptic groups in the European Parliament could also have a negative effect on economic activity.

Figure 9: Real and nominal GDP growth

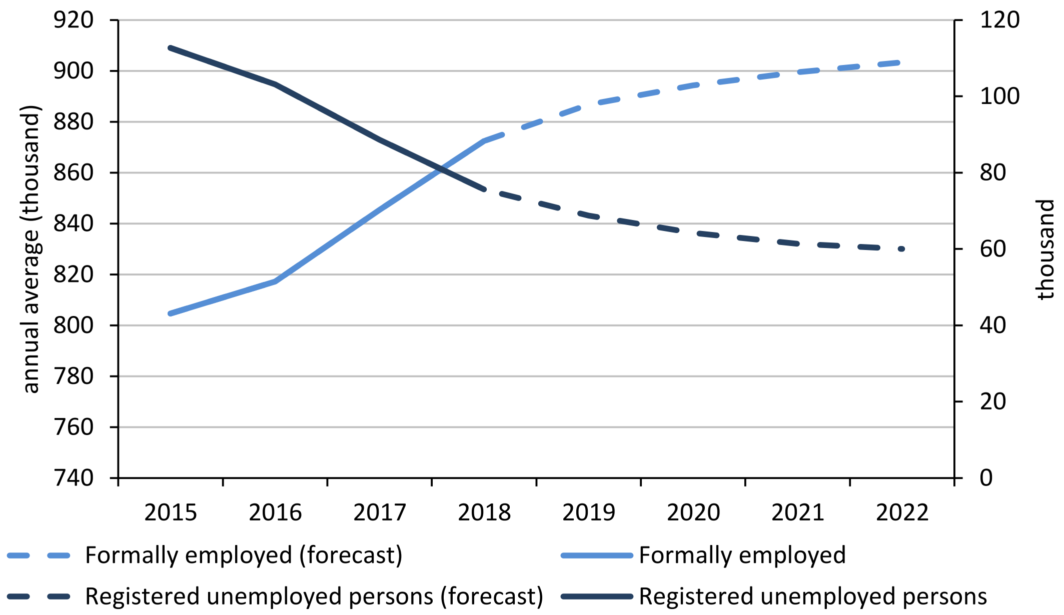


Source: IMAD, spring forecast 2019

Employment will continue to increase in the medium-term period from 2020-2022, but increasingly slowly due to falling numbers of the working age population, lower unemployment and slower growth of economic activity. The impact of demographic trends resulting in the reduction of the workforce will be slightly mitigated by the expected gradual increase in net migration inflows and the increasing rate of participation in the labour market.

The number of unemployed persons will also decrease in the coming years, but more slowly than in the recent period. This will be impacted, in addition to the somewhat lower growth in employment, by the increasingly low unemployment, which will be below the long-term or equilibrium level, which indicates an increasingly limited supply on the labour market.

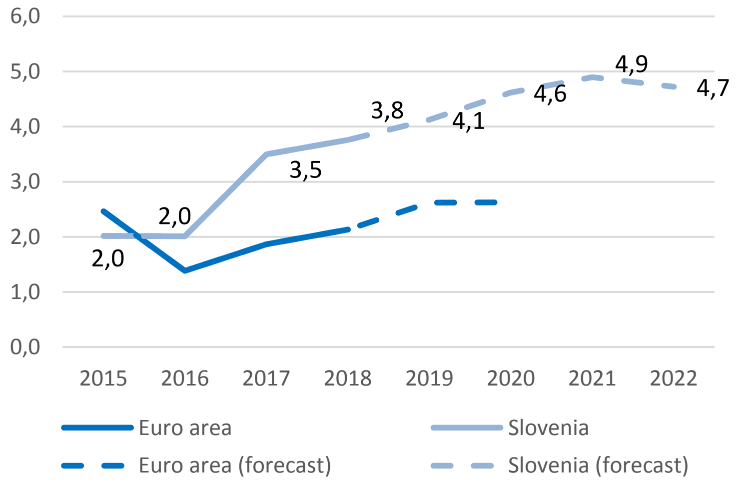
Figure 10: Formally employed and unemployed persons



Source: IMAD, spring forecast 2019

Although the productivity level lags significantly behind the euro area average, its growth is expected to increase in the medium term in comparison with productivity growth in the euro area. Growth in wages will also increase in the next two years (by around 5%), but will be affected by limited job availability as well as agreements with public sector trade unions and legislative changes. Consequently, overall nominal growth in wages will no longer lag behind productivity growth, as in the post-crisis period.

Figure 11: Nominal productivity growth, Slovenia and euro area



Source: IMAD, spring forecast 2019, Ameco database, Eurostat

2.3. Position in the cycle

The output gap estimate[5] is used to determine the position of the economy in the economic cycle, and is the basis for the implementation of fiscal policy. I.e., together with general government debt (as a percentage of GDP) and the indicator of medium-term fiscal sustainability, it is used to determine the size of the required adjustment to the structural budget balance. As the ECB has stated (2005),[6] output gap estimates can play a significant role in modelling and forecasting (as long as the degree of uncertainty is taken into account), while it also notes that output gap estimates should not be given too much weight in economic and policy analysis. On the contrary, instead of focusing on just one indicator, the assessment of the position of the economy in real time should be based on a wide range of indicators.

Namely, according to government estimates, the Slovenian economy's position in the cycle is not as favourable as indicated by the estimated output gap. We have a balance of payments surplus and low unemployment, but despite this, investment, industrial production and the GDP growth rate are all still below the pre-crisis levels. However, there are major uncertainties associated with the calculation of the output gap, and therefore the estimate of an individual country's position in the economic cycle is also uncertain, as has been established by the European Commission[7] and the European Central Bank.[8] Differences in the calculation have a significant effect on the required fiscal effort. When setting numerical targets it is important to

[5] The output gap is the difference between the actual and potential GDP, expressed as a percentage of the potential GDP.
[6] ECB Monthly Bulletin, February 2005
[7] https://ec.europa.eu/info/publications/economy-finance/quarterly-report-euro-area-qrea-vol14-no3-2015_en
[8] https://www.ecb.europa.eu/pub/pdf/scpops/ecbop156.en.pdf?12f64165c5623d34b98b978cbe614ed9

take into account of the variability between the estimated and actual values. The preliminary output gap estimates and the estimates based on actual data differ substantially.

In addition to the calculation method, the uncertainty of the calculation of the output gap is also affected to a certain extent by (1) the method of calculation of the potential output, (2) changes to estimates of past growth, and (3) the GDP forecasts and other macroeconomic data and indicators used to estimate the output gap in the period of the economic forecasts. Therefore there are substantial differences between the estimated output gaps calculated by different institutions, and in addition the final estimates from the individual institutions are often substantially different from their previous estimates.

Table 2: Most recent available estimates[9] of Slovenia's output gap

	MF (SF 2019)	IMAD (SF 2019)	EC (AF 2018)	OECD (november 2018)	IMF (february 2019)
2017	–0.1	0.0	1.1	–1.3	–0.5
2018	1.7	2.1	2.7	0.9	1.2
2019	2.4	2.9	3.0	2.2	1.8
2020	2.6	3.1	2.5	2.4	1.9

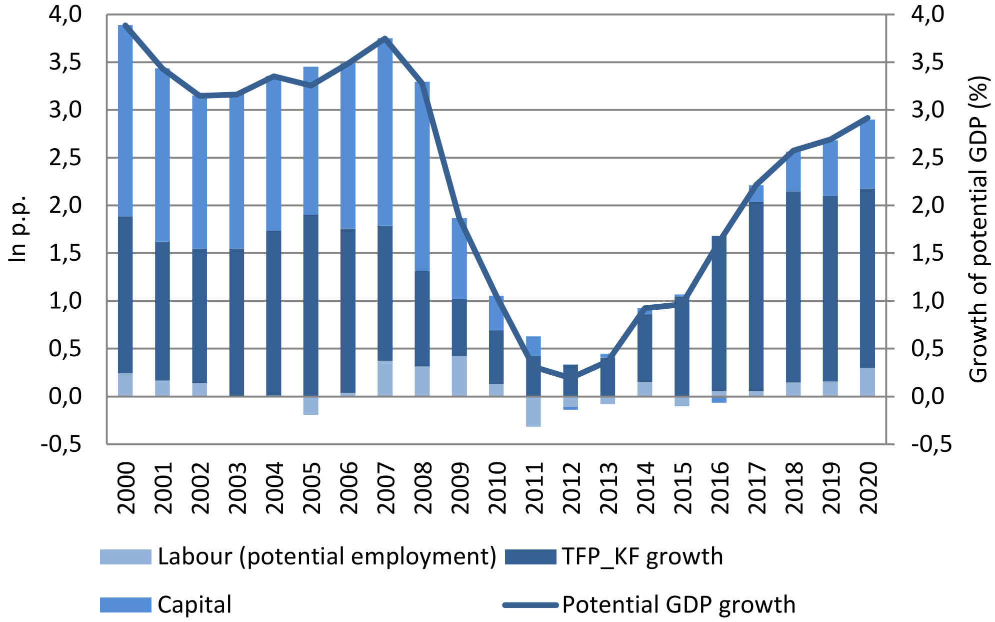
The estimates are particularly uncertain for Slovenia, which therefore in 2017 applied for a country-specific case for the calculation of the output gap according to the current "commonly agreed EU methodology". On the basis of these efforts the output gap estimate for Slovenia better expresses the country's position in the economic cycle, but nevertheless we believe that there is still room for further improvements to the estimate. These improvements could be achieved through better estimates of the NAWRU anchor, particularly for new Member States, for which these estimates are still not satisfactory.

The estimates of the Ministry of Finance, prepared on the basis of IMAD's 2019 Spring Forecast of Economic Trends, indicate that the growth of the potential GDP in 2019 and 2020 should increase slightly (by 0.1 p.p. to 2.7% in 2019, and by 0.2 p.p. to 2.9% in 2020). This growth is primarily the consequence of the high growth of the contribution of capital, with a relatively high and stable contribution of overall factor productivity, and in 2020 also with an increased contribution of labour.

According to the most recent estimates, the output gap in 2019 will equal 2.4% of the potential GDP. Slovenia is expected to reach the peak of the economic cycle in 2020, when the output gap should reach 2.6% of the potential GDP, and is expected to remain in the positive part of the cycle until at least 2022, the last year covered by IMAD's most recent forecasts.

[9] The differences between the calculations by the MF and IMAD and the EC are for the most part the consequence of the different time periods of the forecasts, as the estimates by both IMAD and the MF are based on forecasts over a longer time period (t + 6), while those of the EC are for a significantly shorter period (t + 2), and the size of the NAWRU anchor. The differences in the output gap estimates are also the result of differences in the actual forecasts of macroeconomic indicators and various input data (estimate of regulatory capital in 1995) and the elasticity coefficient used for labour and for capital.

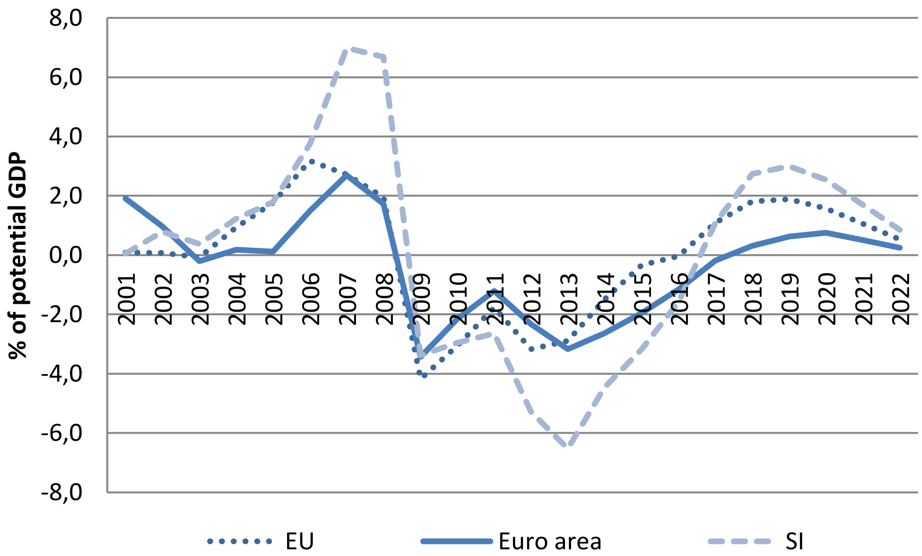
Figure 13: Contribution to growth of potential GDP



Source: SORS, IMAD forecast, MF calculations

Slovenia has a more volatile economic cycle than the euro area as a whole (see Figure 14), which is a consequence of having a small open economy and lower GDP per capita. While the EC's Autumn 2018 Economic Forecast estimated the euro area's output gap in the period 2004-2022 in a range from –3.4% to 2.7% of the potential GDP, in Slovenia this range was more than twice as much (from -6.5% to 7% of the potential GDP).

Figure 14: Output gap (EC autumn 2018 forecast)



Source: EC, MF calculations based on information for the Member States

With regard to the implementation of fiscal policy in accordance with EU commitments and the aforementioned uncertainty of the calculation of the output gap, Slovenia has reservations regarding the appropriateness of the EU matrix used to determine the required annual fiscal adjustments with respect to the position of the economy within the economic cycle. This is particularly true with regard to the required annual fiscal adjustment during times when economies move from negative to positive output gaps and exceed the 1.5% threshold.

Namely, large and sudden improvements in the output gap are common during long-lasting periods of low economic growth or recession, which does not necessarily mean the overheating of the economy, but merely an adjustment of demand from lower levels. Furthermore, fiscal policy guidelines must be sustainable, planned within a multiannual framework, and without sudden adjustments due to major fluctuations of the output gap estimate. Furthermore they should not be loosened when the economy transitions into "good" economic conditions.

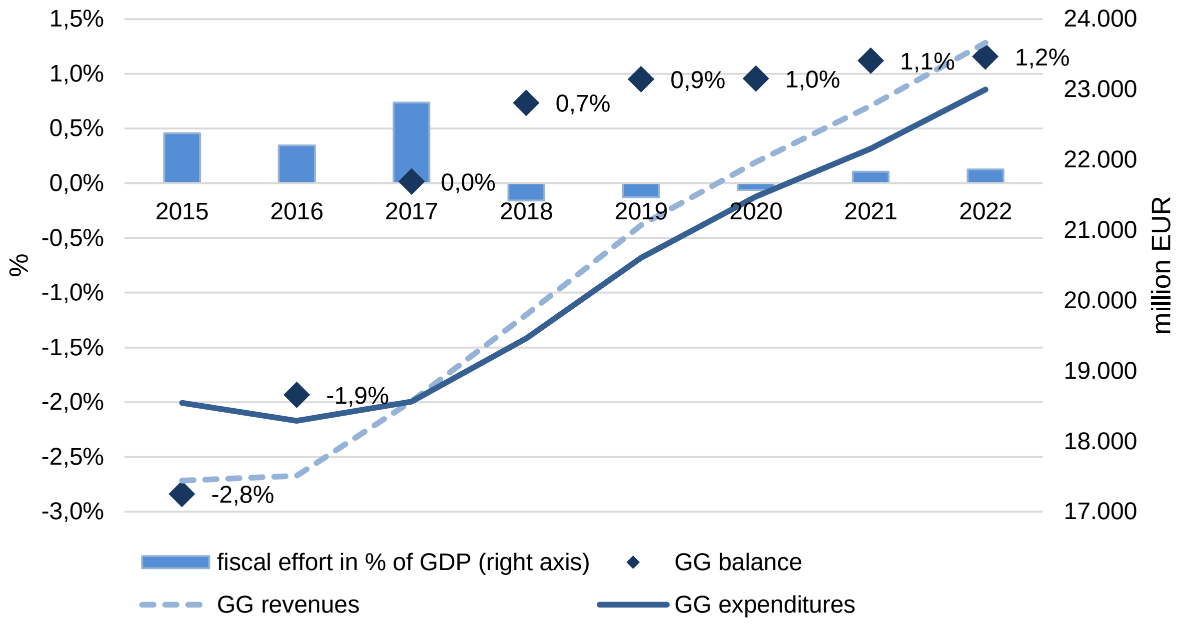
3. ECONOMIC AND FISCAL POLICY

The Government of the Republic of Slovenia began its term on 13 September 2018, and thus after March 2018 (resignation of the prime minister) it was not possible to adopt policies and measures that could affect the state budget for 2019, the individual public finance budgets and the general government. Practically all of 2018 was a consequence of the expiry of limitations and the so-called no-policy-change scenario. Here it should be noted that despite this, Slovenia (comparatively speaking) is not outside the range of structural balances in the euro area (EC calculations), as the euro area on average was 1 percentage point away from balance. The calculations of the Ministry of Finance and the Fiscal Council of the Republic of Slovenia even indicate a balanced position for 2019 (if the limit set out in the Framework is adhered to). In this respect as well, Slovenia consistently exceeds the euro area average for the general government primary balance and posted a primary surplus of 2.7% of GDP in 2018 (euro area average 1.2% of GDP in 2018, Ameco). At the same time, this government discussed the medium-term fiscal framework (Framework for the preparation of general government budgets 2020-2022) for the first time only during the spring cycle of the European Semester. The government has committed to achieving a balanced budget in the medium term, which is addressed in both the Stability Programme and the Framework.

European Commission's view of the path outlined in the Draft Budgetary Plan for 2019, February 2019:

*"In the case of Slovenia there are **risks of non-compliance** with the requirements of the Pact for 2019. The draft budgetary plan could lead to significant deviations from the adjustment path for reaching the medium-term objective. Slovenia is in the preventive arm of the Stability and Growth Pact, and must achieve/ensure a reliable path to a medium-term budgetary objective MTO = 0.25% of GDP. The nominal growth of primary expenditure according to the expenditure growth criterion may not exceed 3.1% in 2019, which represents a fiscal adjustment of 0.65% of GDP. The European Commission finds that a general government balance of 0.6% of GDP is possible, which means that the adjusted structural balance would amount to -1.1% of GDP. The difference in the calculations for 2019 arises from lower positive output gaps and a different investment plan in the EC forecasts."*

Figure 15: Most likely macroeconomic and budgetary scenario (government sector)



Source: Ministry of Finance

Pursuant to the latest macroeconomic forecast we expect to maintain a general government surplus in the medium term. After a surplus in 2018 of 0.7% of GDP (SORS, 19 April 2019), in 2019 the surplus will rise to 0.9% of GDP and then gradually to 1.2% of GDP in 2022. The surplus is a consequence of the positive economic trends, reduced interest rates and public expenditure frozen until 2018. In 2018, due to the no-policy-change scenario, the structural balance fell (from +0.17% of GDP in 2017 to +0.02% of GDP in 2018). Due to the aforementioned reasons and estimates, the required effort will again not be achieved in 2019, but the new medium-term objective of -0.25% of GDP (-0.11% of GDP) will be surpassed. In 2020 the medium-term objective will again be surpassed (structural balance of -0.17% of GDP) and due to the rules of the SGP will improve up to structural balance in 2022 (structural balance of +0.06% of GDP).

3.1. Fiscal outlook for 2018 and 2019

General government revenue has been increasing since 2010, and posted its highest growth in 2018. It amounted to EUR 19,800 million, which is EUR 1,231 million or 6.6% more than in 2017. Measured as a percentage of GDP, government revenue amounted to 43.1% of GDP in 2018. The high year-on-year growth in revenue reflects the favourable conditions in the Slovenian economy and the resulting higher inflows into public funding.

The largest proportion of total revenue in 2018 was accounted for by taxes and social contributions, with the latter increasing by 7.0% or EUR 448 million. Revenues from personal income tax and property taxes also grew strongly (by EUR 375 million or 11.7%). Revenue from income tax increased by EUR 251 million or 11.5%, while revenue from corporate income tax rose by EUR 122 million or 16.0%, which indicates a continued favourable situation in the economy, i.e. favourable national macroeconomic conditions. This growth in revenue from social contributions and income tax indicates that the trend of favourable conditions on the labour market is also continuing. Revenue from taxes on production and imports increased by EUR 323 million or 5.3%, of which VAT by EUR 283 million or 8.1%. Non-tax revenue also increased in 2018. Revenue from profits from state-owned enterprises rose significantly (by EUR 66 million or 20.8%), while interest income decreased by EUR 48 million or 33.7%. Revenue from EU funds in the new financial perspective also increased significantly. Enterprises classified within the government sector also had a positive impact on the general government balance.

In 2019 we are expecting a continuation of the year-on-year growth in general government revenue, which will be most markedly impacted by favourable economic conditions. Revenue is forecast to increase in 2019 by 6.4% to 43.2% of GDP. The largest share of this growth will be contributed by higher revenue from social contributions (7.7%) and revenue from income tax and property tax (6.3%). Due to the effect of the easing of the tax burden on annual leave payments up to the level of 100% of the average wage, income tax revenues in 2019 will be up to EUR 90 million lower than they would otherwise have been. Taxes on production and imports are forecast to increase by 5.7%. Property income will be 10.7% lower relative to 2018, which is for the most part the consequence of high inflows under that item in 2018. The government will mitigate the impact of the partial drop in tax revenue due to the easing of the tax burden on annual leave payments through increased effectiveness in collecting tax revenues.

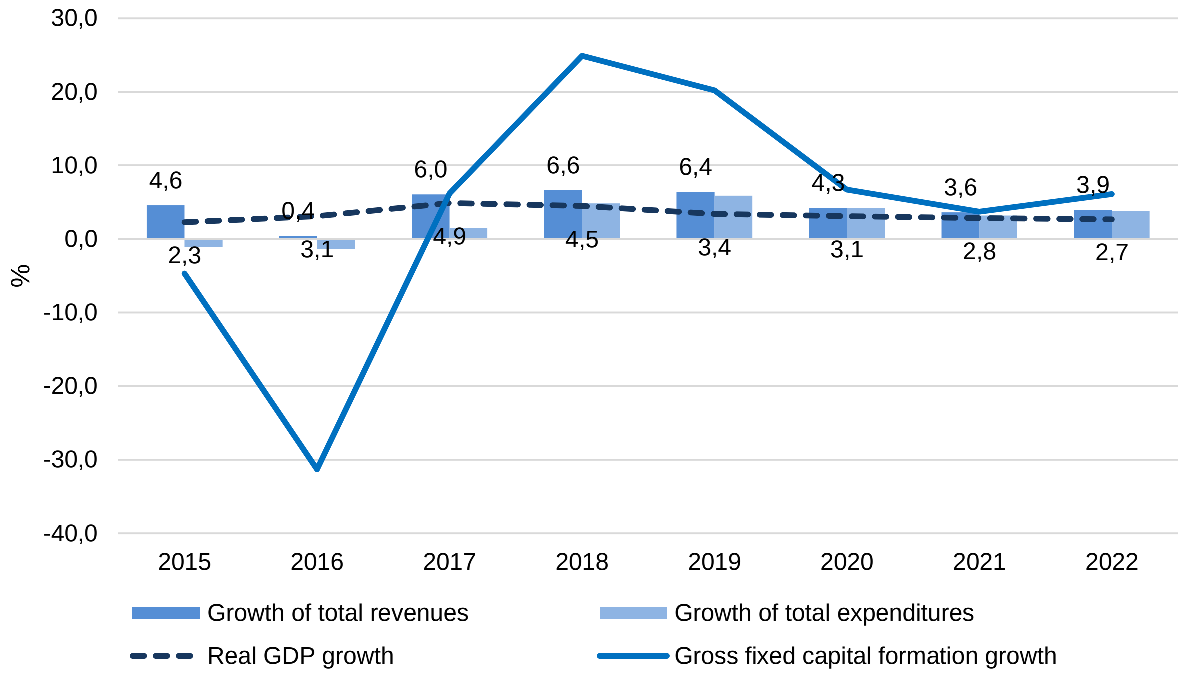
Government expenditure in 2018 increased by EUR 899 million or 4.8% relative to 2017, and amounted to 42.4% of GDP (43.2% of GDP in 2017). Its growth was thus 1.8 percentage points lower than the growth in revenue. The largest share of growth in expenditure in 2018 was contributed by gross fixed capital formation, which was up 24.9% or EUR 331 million. Expenditure also increased for compensation of employees (by 4.4%), intermediate consumption (by 7.0%) and social payments (by 3.6%). The higher level of drawdown of European funds had a positive impact on government expenditure on subsidies, which was up 8.6%. The government reduced expenditure on interest for the third consecutive year in 2018. It was down EUR 161 million or 15.0% on the previous year, and amounted to 2.0% of GDP.

Government expenditure in 2019 is planned in the amount of EUR 20,610 million, which is 42.3% of GDP and 5.9% more than in 2018. Growth in expenditure will remain lower than revenue growth. Expenditure on compensation of employees will increase by 8.9% in 2019, primarily on account of the relaxing of austerity measures in the area of wages and the effects of the strike agreement. Social payments will rise by 4.8%, and similarly to 2018 expenditures for gross fixed capital formation will also increase, by 20.2% or EUR 336 million.

Average revenue growth in the 2015-2018 period was 4.4% and exceeded growth in expenditure by 3.4 percentage points (the average growth in expenditure in the same 2015-2018 period was 1.0%). During its 2019-2022 term, the Slovenian government will gradually, with a focus on priority areas, continue the process of fiscal consolidation, with the goal of a balanced budget in the medium term and an emphasis on ensuring growth (the central element of the Stability and Growth Pact). The fiscal consolidation carried out to date has been positive for the growth of consumption and exports, which are engines of growth, and also led to the implementation of measures (on wages, pensions and social transfers). In the 2019-2022 period the average revenue growth (4.6%) will exceed the average growth in expenditure

(4.3%). Revenue growth will also exceed growth in expenditure on an annual level. There is also a noticeable trend of acceleration of the drawdown of EU funds in connection with investments, which is increasing towards the end of the period of eligibility (in accordance with the n+3 rule).

Figure 16: Growth in general government revenue, expenditure and investments (growth rate)



Source: Ministry of Finance

3.2. The medium-term general government balance and achieving of the medium-term objective 2020-2022

Medium-term fiscal balance was the government's primary objective in the preparation of the revised state budget for 2019 such that according to the estimate of the Ministry of Finance a balanced general government structural balance will be achieved by the end of 2022, where we will already have reached our MTO in 2020. The early elections limited the government's room for manoeuvre for 2019, and therefore from the perspective of the functioning of fiscal policy it was crucial that the revision took account of the already implemented measures and negotiations that had been outlined in 2018 and that the government addressed the medium-term challenges.

Upon the drafting of the revision the assumptions for 2019 and beyond also changed:
- realisation for 2018 (higher than anticipated during the winter), new macroeconomic indicators for 2019 and beyond,
- strike agreements concluded with public sector trade unions,
- unfrozen indexation of transfers to individuals and households (anchors are not valid anymore, end of austerity measures).

The Fiscal Rule Act (FRA) does not envisage any flexibility with regard to deviation from the MTO, while the EU rules as set out in the SGP do allow for this. Slovenia satisfies the conditions for achieving the minimum benchmark[10] and, for dialog purposes with the EC, in the 2019 Stability Programme announces, that it will request a structural flexibility clause (in force from 2020 on) due to changes on the labour market and social activation and/or pension reform.

The estimates of the structural balance for 2018 indicate that the surplus with regard to the data published by SORS (Basic General Government Aggregates, September 2018), the realisation from individual public finance budgets in 2018, the forecasts of the Ministry of Finance and the calculations based on the four individual public finance budgets,[11] will amount to approximately 0.8% of GDP. The SORS calculations in the most recent estimate (19 April 2019) indicate 0.7% of GDP for the government sector.

Table 3: Path to the target scenario for the government sector (ESA-2010)

	2018	2019	2020	2021	2022
Revenue in mio EUR	19800	21072	21968	22767	23660
in % GDP	43.1	43.2	42.6	41.8	41.3
Expenditure in mio EUR	19464	20610	21476	22159	23000
in % GDP	42.4	42.2	41.6	40.7	40.2
Target nominal deficit/surplus in mio EUR	336.6	462.4	491.8	607.8	660.7
in % GDP	0.7	0.9	1.0	1.1	1.2
Target structural deficit in mio EUR	7.6	–54.3	–88.8	–35.4	35.6
in % GDP	0.02	–0.11	–0.17	–0.07	0.06
Fiscal effort as % of GDP	–0.2	–0.1	-0.1	0.1	0.1

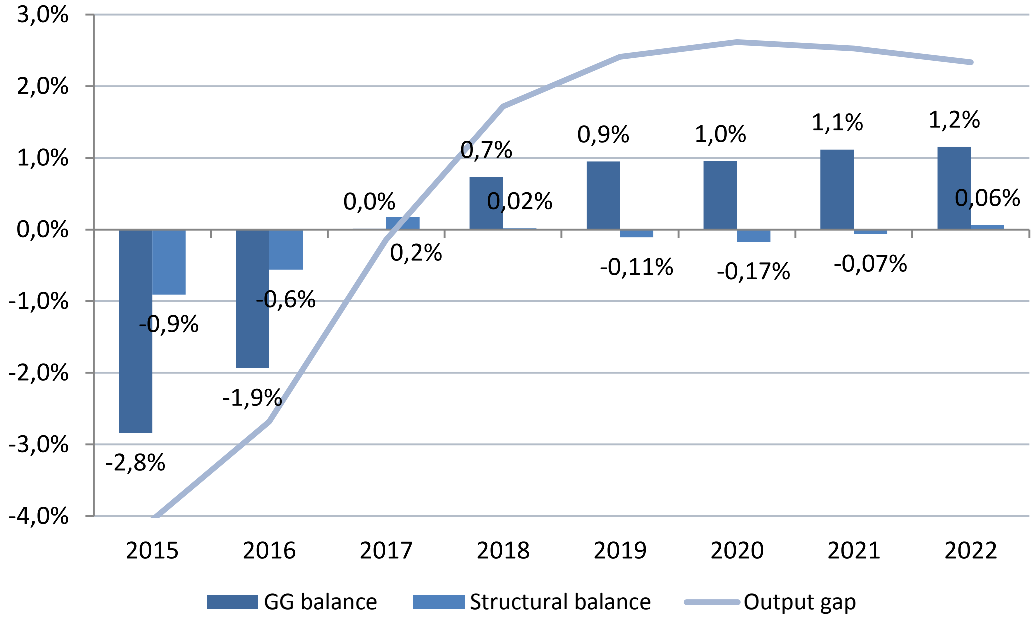
Source: SORS, Ministry of Finance, MF calculations, MF output gap estimate

In the medium term, Slovenia is planning to gradually improve the general government balance and the cyclically adjusted balance in line with the MTO. Therefore in fiscal planning it is necessary to focus on structural measures that will have a long-lasting effect on the structure and efficiency of public finances. Systemic measures that will allow us to maintain the medium-term objective and provide a sustainable long-term structural balance are planned to be drafted in 2019 and put into force in 2020. However, it will be necessary to take account of the specifics of small Member States, and achieve an appropriate level of potential growth while being aware of the costs of the ageing of the population.

[10] The minimum benchmark (MB) is a part of the formula for calculating the MTO. The components MTO_{MB} and $MTO_{Euro/ERM2}$ are the starting points for the calculation of the MTO. As determined by the Economic and Financial Committee (EFC) and in the requirements of the Pact for euro area countries and EU Member States participating in ERM II, the MTO may not be lower than -1% of GDP. The minimum benchmark for Slovenia for the medium term, in accordance with the approval of the EFC members and on the basis of the EC's calculation, is -0.9.

[11] The four individual public finance budgets on the cash flow principle are montly monitored and represent approximately 80% of the general government sector. The remaining 20% is monitored using ESA2010 methodology, but is difficult to make a precise estimate, as also indicated by the yearly changes/ revisions of the EDP (SORS, 19 April 2019).

Figure 17: General government balance and structural balance, in % of GDP – required target scenario, MF output gap (EC methodology)



Source: Ministry of Finance, MF calculations

Table 4: Cyclical policy developments (output gap – average estimate)

	as % of GDP	ESA koda	2018	2019	2020	2021	2022
1.	Real GDP growth (%)		4.5	3.4	3.1	2.8	2.7
2.	Actual general government balance	B.9	0.7	0.9	1.0	1.1	1.2
3.	Interest expenditure	D.41	2.0	1.6	1.5	1.3	1.2
4.	One-off and other temporary measures		–0.1	–0.1	–0.1	0.0	0.0
5.	Potential GDP growth (%)		2.6	2.7	2.9	2.9	2.9
	Contributions:						
	- labour		0.1	0.2	0.3	0.3	0.1
	- capital		0.4	0.6	0.7	0.9	1.0
	- total factor productivity		2.0	1.9	1.9	1.8	1.7
6.	Output gap (%)		1.7	2.4	2.6	2.5	2.3
7.	Cyclical general government balance		0.8	1.2	1.2	1.2	1.1
8.	Cyclically adjusted general government balance		–0.1	–0.2	–0.3	–0.1	0.1
9.	Changes in cyclically adjusted general government balance		–0.2	–0.1	-0.1	0.2	0.1
10.	Structural balance		0.0	–0.1	–0.2	–0.1	0.1
11.	Changes in structural deficit (fiscal effort)		–0.2	–0.1	-0.1	0.1	0.1

Source: SORS, Ministry of Finance

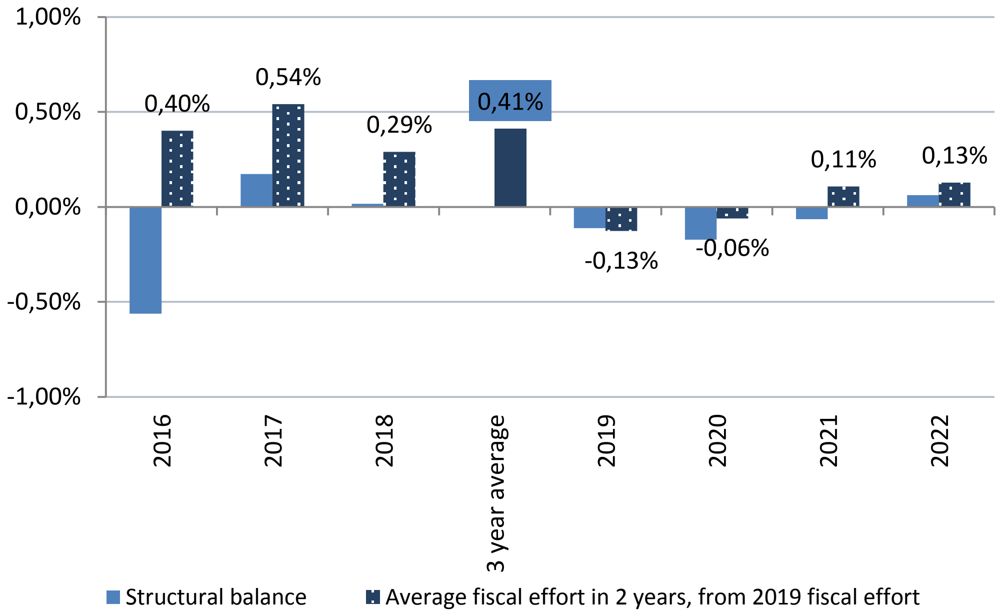
With regard to achieving compliance in the past (2017, 2018) assuming a no-policy-change scenario, in the figure below we illustrate the developments of the general government balance, the structural balance, the level of fiscal effort and the two-year average achieved and planned fiscal effort. The Slovenian government was ex post compliant with the national fiscal rule

(FRA) and partially compliant with the rules set out in the Stability and Growth Pact (2017, 2018). In order to be fully compliant with the FRA and to achieve the medium-term objective, the Slovenian government prepared the Ordinance on the Preparation of Budgets 2020-2022, determined the target balances for the general government and the fourindividual public finance budgets , and set the upper limit for expenditure.

In light of the new IMAD spring forecast, the Framework for the Preparation of General Government Budgets 2018-2020, the amendments for 2019 (21 December 2018, OG 82/2018) and the findings set out in the opinion of the Fiscal Council,[12] with nearly identical positive output gap estimates, the estimate of the structural balance will also change. Based on the projections in the 2019 SP, it will decline less than in the forecast made on the basis of the framework adopted in December 2018. The Fiscal Council presents nine calculations, and explains that the averages calculated in Table 4.8 (p. 37) show that the government, taking account of the expenditure limit for 2019 (EUR 20,610 million), is in compliance with the fiscal rule.

In order for Slovenia to reach the MTO, it must achieve the minimum fiscal consolidation by 2020, so that it achieves a structural balance at the level of the structural deficit of -0.25% of GDP (see figure below) or a nominal balance of +1% of GDP. If we evaluate the fiscal consolidation to date (overall average of 0.41% of GDP in 2016-2018), together with the decline in 2019, this objective is realistically attainable by 2022 with respect to the planned path, and is compliant with the SGP (we envisage a structural balance of +0.1% in 2022). With respect to the figure below we can conclude that Slovenia is making progress towards the medium-term objective, along the planned path and using appropriate measures.

Figure 18: Structural balance and year-on-year change to the structural balance (in % of GDP) achieved in 2016-2018 and required in 2020-2022

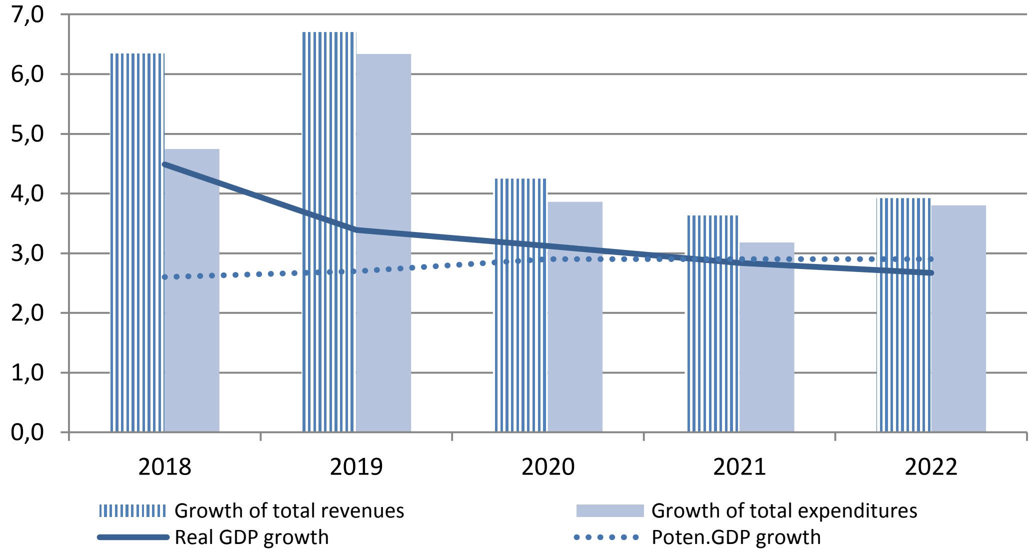


Source: Ministry of Finance

[12] http://www.fs-rs.si/wp-content/uploads/2019/04/Ocena-april-2019.pdf

In the figure below we present the changes in fiscal expenditure in order to achieve the fiscal objectives such that we will be compliant with the fiscal rule set out in the FRA as early as 2020, and compliant in 2022 with the SGP, which has different starting points/assumptions (amounts of increased revenue/expenditure from 2018 in the form of growth rates, in which the increase in expenditure lags behind the increase in revenue, taking account of the IMAD spring forecast and the MF projections up to 2022).

Figure 19: Growth in fiscal revenue, expenditure, real and potential GDP growth in %



Source: Ministry of Finance

In 2018 the European Commission recommended, in connection with public finances within the framework of the European Semester, that Slovenia not exceed 3.1% nominal growth rate of net primary fiscal expenditure in 2019, which represents an annual structural adjustment of 0.65% of GDP. In order to obtain an estimate of appropriate growth of expenditure, expenditures for interest, the cyclical component of unemployment benefits and expenditures on EU programmes fully matched by EU funds revenue are subtracted from all expenditures. The four-year averages of investment expenditure are used, which do not include funds received from the EU for investment. According to estimates, such expenditure will grow more quickly in 2019. In the 2020-2022 period, Slovenia will reach and maintain the MTO, and the planned expenditure will not exceed the allowable growth of expenditure. According to the calculations of the Ministry of Finance, the average long-term growth rate of the potential output in 2020 will be around 4.95%, and will be higher than the planned growth of such expenditures. Even using an alternative approach according to the methodology proposed by Fuest and Gros (2019),[13] expenditure could grow by around 4.88% or 4.93%, depending on the inclusion of the factor for bringing the public debt below the 60% of GDP threshold within the next 20 (factor 0.05) or 50 years (factor 0.02). Therefore, the allowable growth rate of expenditure is slightly lower than the calculated average long-term growth rate of the potential output. The difference is low due to the fact that the debt in 2020 is only slightly higher than 60% of GDP. The planned growth of overall expenditure in 2020 is lower than the allowable level at 4.2%. However, the

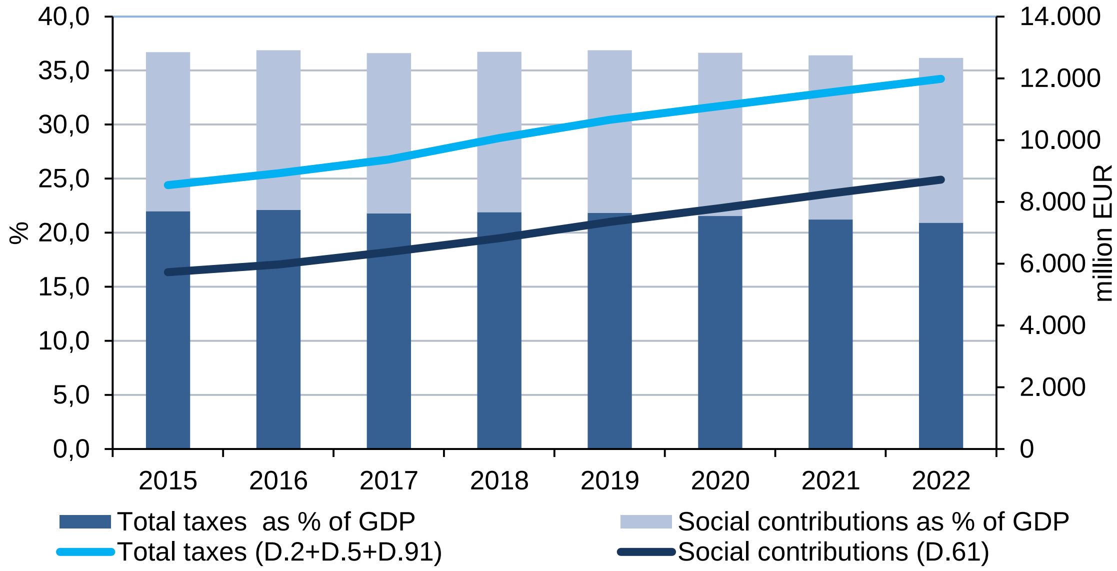
[13] Fuest, C. and Gros, D. (2019). Applying Nominal Expenditure Rules in the Euro Area, Policy Brief. Econpol, IFO Institute, 2019.

criterion of expenditure also does not eliminate the problem of transparency, since, as noted in professional circles (and in Slovenia also by the Fiscal Council), neither SORS nor Eurostat publish data on expenditure for EU programmes which perfectly correspond to revenue from EU funds. Similarly, the multi-annual average of potential GDP growth also comes into consideration where Member States (including Slovenia) are warning about the volatility of output gap estimates.

3.3. General government revenue

Growth in government revenue is also expected in the medium term, but will gradually slow. In the 2020-2022 period, general government revenue will grow at an average rate of 3.9% annually. Year-on-year growth will amount to 4.3% in 2020. The largest share of this growth will be contributed by higher revenue from social contributions, which will rise by 6.2%. Tax revenues will also increase (by 4.2%), but this growth will be moderate. Among tax revenues, the highest growth rate will continue to be in taxes on income and wealth (6.0%), primarily personal income tax (6.7%), while corporate income tax will be up 5.4%. Taxes on production and imports will be up 3.2%, primarily due to higher VAT revenues. Revenue growth will slow further in 2021 and will amount to 3.6%. Revenue from social contributions will be up 6.0%. Revenue from taxes on income and wealth will be up by 5.3%, while revenue from taxes on production and imports are forecast to increase by 3.2%. Slightly higher growth in government revenue is planned in 2022 (3.9%). Similar to past years, revenue from social contributions will experience the fastest growth (5.5%). Revenue from taxes on income and wealth will grow at a similar rate (5.3%). Growth of taxes on production and imports will amount to 2.9%. Unlike revenue from taxes and social contributions, property income will decline in the 2020-2022 period at an average of 8.9% annually. The decrease will be the consequence of lower interest income and lower revenue from profit distributions at state-owned companies.

Figure 20: Tax burdens and contributions in EUR and in % of GDP



Source: Ministry of Finance

– <u>Management of (non-)tax (and capital) income</u>

The key guideline in the drafting of changes to tax policy is tax relief on labour costs and increasing disposable income. The tax reform proposal envisages increasing general and additional general tax allowances and changes to the income tax brackets in terms of both the levels and the limits of the tax brackets. It also proposes the easing of the tax burden on annual leave payments and social security contributions. In order to ensure long-term fiscal sustainability, it also proposes measures for the restructuring of tax levies, i.e. measures to mitigate shortfalls in the most neutral possible manner. The government proposal includes measures focused on increasing the tax burden on capital.

In order to develop a modern business environment, including in the area of taxes, we will require measures aimed at the informatisation of procedures and the simplicity of meeting the obligation of payment of public duties, which will be accomplished through the introduction of mobile apps and through the upgrading of the tax and customs IT systems. By preventing abuse in the area of payment of public duties through the securing of tax liabilities, we will reduce the current tax shortfall in the long term and directly prevent the appearance of new tax shortfalls. Under these measures, in the coming period, in addition to organisational measures, Slovenia is also making all necessary preparations for the transposition of the provisions of the Anti-Tax Avoidance Directive.

Since 2013, when the National Assembly adopted a list of 15 companies to be privatised, followed in 2015 by the Decree on the Strategy for Managing State Capital Investments, the Slovenian Sovereign Holding Company (SDH), as the centralised administrator of the state's capital investments, has sold state capital investments in 24 firms, including Nova Ljubljanska Banka (NLB). In addition, the pension and disability insurer KAD sold its interest in the Gorenje company in 2018. Since 2013, the state budget has received a total of EUR 1,043 billion in proceeds from privatisation.

With the listing of NLB shares, SDH concluded the first step towards the privatisation of NLB. The Republic of Slovenia also met the first part of its commitments to the European Commission relating to the privatisation of NLB, which were made as a consequence of the provision of State aid in 2013 (and which were amended in 2018). The IPO resulted in the sale of 65% of NLB shares. In accordance with Slovenia's commitments to the European Commission, the remaining shares up to 75% minus one share will be sold by the end of 2019. In accordance with its commitments, SDH has already initiated the sales procedure for the Republic of Slovenia's 100% stake in Abanka, which will be concluded no later than 30 June 2019.

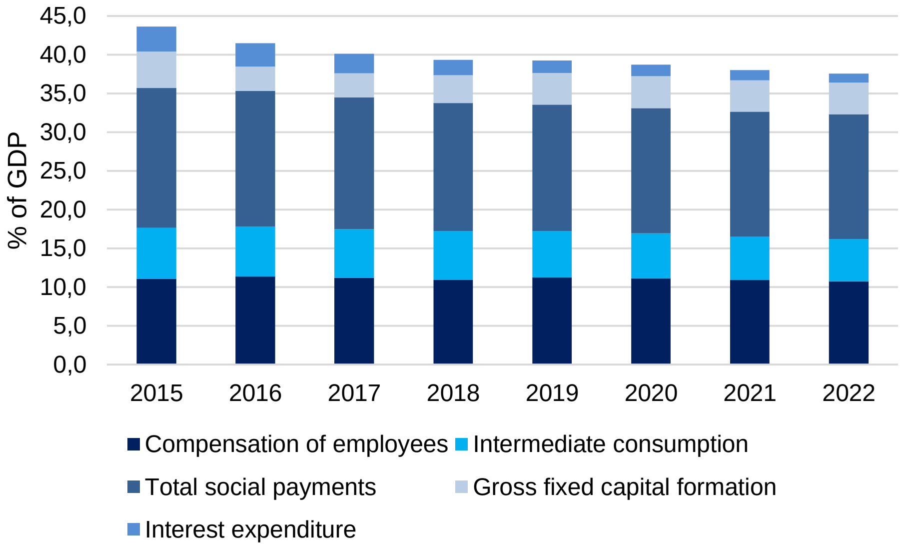
SDH's primary task is to provide the conditions for active management of investments pursuant to the strategy and the annual plans for managing capital assets. The financial year 2017 was successful with respect to dividends, as EUR 446.9 million in dividends was paid into the state budget in 2018.

3.4. General government expenditure

In 2019 we expect expenditure growth of 5.9%, which will amount to 42.3% of GDP. The percentage of the GDP does not show an accelerated increase in expenditure, but indicates the continuation of policies from 2018 in the area of employee compensation and social security benefits, which cover a very broad area under ESA2010 (from compensation for sick leave, social benefits in cash and family policy measures to transport allowances).

Expenditure growth will slow in the medium term, but in relative terms as a percentage of GDP it will be negative. Expenditure will grow 3.7% on average from 2020 to 2022. In 2020, general government expenditure will increase by 4.2%, but will fall to 41.6% of GDP. In 2021 it will increase by 3.2%, but in terms of percentage it will fall to 40.7% of GDP. A similar trend will continue in 2022, when general government expenditure will increase by 3.8%, but will fall further to 40.2% of GDP. By the end of the medium-term period, the growth of general government expenditure will be compliant with the objective of achieving the improvement of the general government balance with the planned increased revenue and taking the fiscal rule into account (and partly with the creation of space for a fiscal buffer, since the structural balance will be completely balanced in 2022).

Figure 21: Key components of general government expenditure in % of GDP



Source: Ministry of Finance

- <u>Compensation of employees</u>

Representatives of trade unions and certain public sector trade unions announced a strike at the end of 2017. The negotiations over the strike demands, which started at the beginning of 2018, were suspended due to the stepping down of the government and the new elections, but were re-started in the autumn owing to the revised strike demands. The government managed to agree with the majority of the trade unions on the withdrawal of the strike demands relating to wages and other remuneration of civil servants, and in December 2018 signed the Agreement on Wages and Other Costs of Labour in the Public Sector. The impact of this agreement will be realised gradually, over three years.

- The funding of labour costs in the 2019-2021 period thus includes growth due to: regular promotions, which shall be begun to be paid out in December each year, the strike agreement, based on which the wages of the majority of employees will increase.
- Bonuses and certain other expenditure will be increased, while at the same time the restriction on the payment of performance bonuses will still apply until July 2020, and a permanent delay in payment for promotions will be introduced on 1 December of this year.
- A higher minimum wage (Jan. 2019), which affects both the minimum salary and the level of the annual leave allowance for all public sector employees.

There is no agreement for 2022, therefore the projections assume an increased amount of funds for labour costs at the average growth rate for such funds in the previous year. Certain measures or reductions, which were agreed upon as early as 2012, are still in effect, as they were intended to be permanent (e.g. transport to and from work, meal allowances, separate living allowances, business travel per diems, lowering the value of the wage scale by 8%, etc.). Despite the permanent nature of these measures, the trade unions would like to hold negotiations over the restoration of these rights, an agreement on the determination of norms and standards in certain commercial activities (social and health care) and the introduction of a mechanism for annual wage adjustment.

In the area of public sector salaries in the future, we are planning a closer connection between remuneration for work and performance, increased autonomy of management in determining salaries, and reducing discrepancies in the basic salaries of civil servants for doing equal work. We will also study the provisions of the Public Sector Salary System Act and the collective agreement for the public sector relating to the regulation of ordinary performance bonuses, and develop objective criteria that will on the one hand simplify the procedure for awarding performance bonuses, and on the other will award performance bonuses to civil servants who achieve above-average results. We will also place greater emphasis on training management personnel and department heads in effective management. A review will be prepared of the system of promotions and career advancement, on the basis of which we will identify any unjustified differences between activities and within activities, and differences in salaries. We will continue to cooperate with the public sector trade unions with regard to the meeting of commitments set out in the agreement and the strike agreements, and on the fundamental issues in the area of civil service legislation and the pay system in the public sector.

- Social security benefits

Expenditure on social transfers (not including pensions) is forecast to increase by 6.3% in 2019, and by 2.7% in 2020. Growth is forecast at around 4% in 2021 and 2022. The high growth rate in 2019 is the consequence of the releasing of the measures put into place along with fiscal consolidation and various changes (for a detailed explanation see the 2018 Stability Programme). Lower forecast growth after 2020 is partly the consequence of certain measures in the area of labour market regulation and social activation.

Transfers to the unemployed, in parallel with the improved conditions on the labour market and planned measures such as reducing the period of eligibility for maximum unemployment benefits, will fall by 2.9% in 2019, and by 22.5% in 2020.

Social security transfers are forecast to rise by 27.7% in 2019 due to the increase in the minimum income. In 2020, due to new measures, such as the change to the system of jobseekers' allowances by recipients of cash assistance, social security transfers are planned to be reduced by 13.4%.

The largest share of expenditure for social transfers is expenditure for pensions, which will increase by 3.8% in 2019 in line with the planned adjustment of pensions and the growth in the number of pensioners. The decision to pay an annual allowance to all pensioners will also affect this growth. From 2020 to 2022, approximately 6% growth is planned due to higher wage growth, while growth in the number of pensioners will continue to be moderate.

- <u>Expenditure on interest</u>

Government expenditure on interest has been falling since 2015, when it stood at EUR 1,252 million or 3.2% of GDP. Expenditure on interest has been falling by an average of 0.4 percentage points of GDP annually, and stood at EUR 911 million or 2.0% of GDP in 2018. A similar trend can be expected in the future due to active debt management. We estimate that government expenditure on interest in 2019 will amount to EUR 795 million or 1.6% of GDP, and this percentage is expected to fall to 1.2% of GDP by 2022.

- <u>Subsidies</u>

Upon the commencement of drawdown of European funds, government subsidies in 2018 increased year-on-year by 8.6% to EUR 350 million or 0.8% of GDP. Increased expenditure for subsidies is also expected in 2019 (by 4.8%) and 2020 (by 7.1%), primarily on account of successful drawdown of European funds. In 2021, expenditure for subsidies will remain at the level from the previous year, and in 2022 it will again increase by 2.6% and fluctuate at around the level of 0.7% of GDP.

- <u>Gross fixed capital formation</u>

Government expenditure on gross fixed capital formation in 2018 increased by 0.5 percentage points relative to 2017, to 3.6% of GDP. This increase can also be partially attributed to the successful drawdown of European finds and the resulting higher revenues in this category. The growth of gross capital formation will continue in 2019, when it will increase to 4.1% of GDP. Fixed capital formation will also be maintained at a similar level in the medium term, at an average of 4.1% of GDP in the 2020-2022 period. Various delays occur in the drawdown of European funds, but due to the end of the financial perspective (2014-2020), accelerated drawdown of European funds is planned in 2020 which will have a positive effect on the growth of capital formation.

- <u>Forecasts assuming a no-policy-change scenario</u>

The measures evaluated in 2018, upon the prior achievement of an improved general government balance along with planned higher revenues, can from the perspective of the assumption of unchanged policies from 2020 onwards be summarised in the following table, which covers all of the abovementioned types of general government expenditure. A difference appears in social security benefits, at the level of 0.2% of GDP in 2020, which is the precise amount that we are requesting in a flexibility clause.

Table 5: Forecasts assuming a no-policy-change scenario

		ESA Code	2018 level	2018	2019	2020	2021	2022
			mio EUR	*in % of GDP*				
1.	Total revenues under no-policy-change	TR	19.800.4	43.09	43.18	42.59	41.82	41.35
a.	Taxes on production and imports	D.2	6.464.5	14.07	14	13.67	13.37	13.08
2.	Total expenditure under no-policy-change	TE	19.463.8	42.36	42.24	41.89	40.95	40.44
a.	Funds for employees and intermediate government consumption	D.1+P.2	7.909.2	17.21	17.22	16.94	16.52	16.18
b.	Social benefits		7.592.7	16.52	16.31	16.4	16.35	16.37
c.	Net lending/net borrowing	D.41	910.5	1.98	1.63	1.47	1.31	1.16
d.	Total revenues under no-policy-change	D.3	349.9	0.76	0.75	0.76	0.72	0.71
e.	Taxes on production and imports	P.51	1.662.5	3.62	4.1	4.13	4.06	4.1
3.	Total expenditure under no-policy-change	B.9	336.6	0.73	0.95	0.7	0.87	0.9

Source: SORS (publication of 19 April 2019), Ministry of Finance projections

- <u>Introduction of one-off expenditures</u>

In 2018, one-off expenditures amounted to EUR 47.7 million (lawsuit by the City of Ljubljana for a share of revenues pursuant to the Capital City of the Republic of Slovenia Act and payment of interest on old foreign currency deposits transferred to Croatian banks and paid out to depositors in the nineteen-nineties). The Government of the Republic of Slovenia was briefed on the status of open judicial, out-of-court, arbitral and other proceedings associated with increased budgetary and other risk (Internal, March 2019), therefore for 2019 and beyond we estimate that due to the lodging of a large number of lawsuits (denationalisation, investment disputes, the Act Regulating the Compensation for Damage Sustained as a Result of Erasure from the Register of Permanent Residents, etc.), one-off costs will be maintained at a level of 0.1% of GDP (in addition to the payment of interest commitments to foreign currency depositors we are also taking into account a lawsuit over agricultural land and a dispute over the investments procedure).

3.5. Comparison of economic and budgetary forecasts with the 2018 Stability Programme

In comparison with the 2018 Stability Programme, the forecast GDP growth is lower, i.e. adjusted downwards, for the entire programming period. The IMAD 2019 Spring Forecast foresees a gradual slowing of economic growth this year (3.4%) and in the next two years (3.1% and 2.8%). Owing to the slowdown of the growth of the export-oriented side of the economy, economic growth in 2018 was already somewhat lower than forecast in the 2018 Spring Stability Programme. The risk of lower economic growth (with respect to the previous programme) is increasing, and comes mainly from the international (i.e. external) environment.

The projections of general government surpluse are higher i.e. more favourable throughout the programming period than those presented in the previous 2018 Stability Programme; particularly on account of i) revised macroeconomic starting points on the part of IMAD (2019 spring forecast), and ii) planned revenue and expenditure on account of the adopted economic and social policy measures.

Table 6: Comparison of forecasts of economic and budgetary indicators with the previous programme

in % of GDP	2018	2019	2020	2021	2022
1. *Growth in GDP*					
2017 Stability Programme	5.1	3.8	3.2	3.0	3.0
2018 Stability Programme	4.5	3.4	3.1	2.8	2.7
Difference	–0.6	–0.4	–0.1	–0.2	–0.3
2. *General government balance*					
2017 Stability Programme	0.4	0.2	0.6	0.9	
2018 Stability Programme	0.7	0.9	1.0	1.1	1.2
Difference	0.3	0.7	0.4	0.2	
3. *General government debt*					
2017 Stability Programme	69.3	65.2	61.5	58.3	
2018 Stability Programme	70.1	65.4	61.3	57.9	54.7
Difference	0.8	0.2	–0.2	–0.4	

Source: SORS, IMAD, Ministry of Finance

In the latest (autumn) forecasts for 2018, the majority of institutions slightly underestimated real economic growth. Only two institutions prepared a totally accurate forecast. In the 2017 spring forecasts the institutions expected that economic growth in 2018 would stand at just under 3% on average, while the forecasts of the national institutions (IMAD and the Bank of Slovenia) were on average more optimistic than the foreign ones. By the spring of 2018, the institutions' forecasts for the current year had been increased mostly on account of two main factors, i.e. favourable export trends and domestic consumption. The lowest economic growth was forecast by WIIW (3.9%), and the highest by IMAD (5.1%). The Bank of Slovenia was the closest to the actual value with an error of 0.1 percentage points. On average, the economic growth forecasts for 2018 fluctuated around 4.4%, which is very close to the actual value of 4.5%. Completely accurate final forecasts for 2018 were prepared by IMF and WIIW, while the errors of the other institutions fluctuated over a range of between -0.1 and -0.3 percentage points.

In its 2019 interim winter forecast, the European Commission estimated 4.4-percent economic growth for 2018. The GDP growth forecast was thus the same as the estimate in the Revised Draft Budgetary Plan for 2019, which was based on IMAD's 2018 autumn forecast. In 2019 and 2020 the Commission expects Slovenia's GDP to grow by 3.1% and 2.8% respectively, primarily on account of consumption, which is expected to grow along with employment and continued wage growth. At the same time, the Commission also envisages the maintaining of a stable level of corporate investment and continued growth in public investment, including that supported by EU funds.

Table 7: Error in forecasts of real economic growth by various institutions for 2018 compared with the outcome (4.5%).

Realisation 2018: 4.5 %	2017 Spring forecast for year 2018		2017 Autumn forecast for year 2018		2018 Spring forecast for year 2018		2018 Autumn forecast for year 2018	
	Forecast	Error in p. p.	Forecast	Error in p.p.	Forecast	Error in p.p.	Forecast	Error in p.p.
IMAD	3.2	–1.3	3.9	–0.6	5.1	0.6	4.4	–0.1
BS	3.1	–1.4	4.2	–0.3	4.6	0.1	4.2	–0.3
EC	3.1	–1.4	4.0	–0.5	4.7	0.2	4.3	–0.2
IMF	2.0	–2.5	2.5	–2.0	4.0	–0.5	4.5	0
WIIW	2.9	–1.6	3.9	–0.6	3.9	–0.6	4.5	0
OECD	3.1	–1.4	4.3	–0.2	5.0	0.5	4.4	–0.1
Consensus	2.5	–2.0	3.0	–1.5	4.1	–0.4	4.4	–0.1

Source: Forecasts of the individual institutions, IMAD calculation

For the current year 2019, the most recent forecasts with respect to the general government surplus by both the European Commission (0.4% of GDP) and the forecast set out in the Revised Draft Budgetary Plan for 2019 (0.55% of GDP) are less optimistic in comparison with the most recent estimate in the 2019 Stability Programme, which forecasts a general government surplus of 0.8% of GDP.

Table 8: Comparison of forecasts in the 2019 Stability Programme with the EC's final (winter or autumn) forecast and *with the forecast in the Revised Draft Budgetary Plan for 2019*

	v % BDP	2018	2019	2020	2021
1.	*GDP growth*				
	DBP 2019 – noveliran (january 2019)	*4.4*	*3.7*		
	SP 2019 (spring 2019)	*4.5*	*3.4*	*3.1*	*2.8*
	EC (winter 2019)	*4.4*	*3.1*	*2.8*	
2.	*General government balance*				
	DBP 2019 – noveliran (january 2019)	*0.8*	*0.55*		
	SP 2019 (spring 2019)	*0.7*	*0.9*	*1.0*	*1.1*
	EC (autumn 2018)	*0.5*	*0.4*	*0.2*	
3.	*General government debt*				
	DBP 2019 – noveliran (january 2019)	*70.3*	*66.0*		
	SP 2019 (spring 2019)	*70.1*	*65.4*	*61.3*	*57.9*
	EC (autumn 2018)	*70.2*	*66.3*	*62.6*	

Source: SORS, IMAD, EC, MINISTRY OF FINANCE

3.6. General government debt

Consolidated gross government debt at the end of 2018 amounted to EUR 32,232 million or 70.1% of GDP, which was EUR 373 million more than in 2017 when it amounted EUR 31,859 million or 74.1% of GDP. Central government debt in 2018 amounted to EUR 31,651 million or 68.9% of GDP and represents the main decrease of government debt. Local government level debt amounted to EUR 806 million or 1.8% of GDP, which was EUR 27 million more than in

2017 when it amounted EUR 778 million or 1,8 % of GDP. In 2018 social security funds generated a very low debt. It amounted to EUR 0.6 million.

Following the Public Finance Act, financing of the central government budget execution and debt management operations, in a given fiscal year allows the government to borrow, within a given fiscal year, for financing the deficit of central government budget including the Lending and Repayment Account deficit and financing debt repayments in the current and following two fiscal years. Due to favourable market conditions of debt capital markets in 2018 the Republic of Slovenia has used the possibility of pre-financing in a total amount EUR 570 million while following all the requirements from the SGP Debt rule.

After reaching its peak in 2015 with 82,6% GDP, the debt ratio fall to 70.1% of GDP at the end of 2018. In the next medium term, further decrease of general government debt is expected. The debt estimate for the year 2019 envisages the privatization proceeds from NLB d.d. received in the year 2018. No other potential privatisation proceeds are envisaged in projections. The general government debt projection envisages the prefinancing level reduction over the observed period which is in essence reduction of budget cash reserves. The debt dynamics will be driven primarily by GDP growth and the central government debt movement through the lending and repayment account (B-balance). Local government debt is expected to remain at 2% of GDP.

Table 9: General government debt development

	ESA Code	2018	2019	2020	2021	2022
			mln EUR			
1. Gross debt		32,232	31,910	31,634	31,546	31,314
2. GDP		45,948	48,797	51,578	54,443	57,224
			% of GDP			
3. Gross debt		70.1	65.4	61.3	57.9	54.7
4. Change in gross debt ratio		-3.9	-4.7	-4.1	-3.4	-3.2
5. Primary balance		2.7	2.0	2.3	2.5	2.2
6. Interest expenditure	EDP D.41	2.0	1.6	1.5	1.3	1.2
7. Stock Flow Adjustment		1.5	-0.3	0.3	1.0	0.6
Implicit interest rate on debt		2.9	2.5	2.4	2.3	2.1

Source: Source: Ministry of Finance, Treasury Directorate

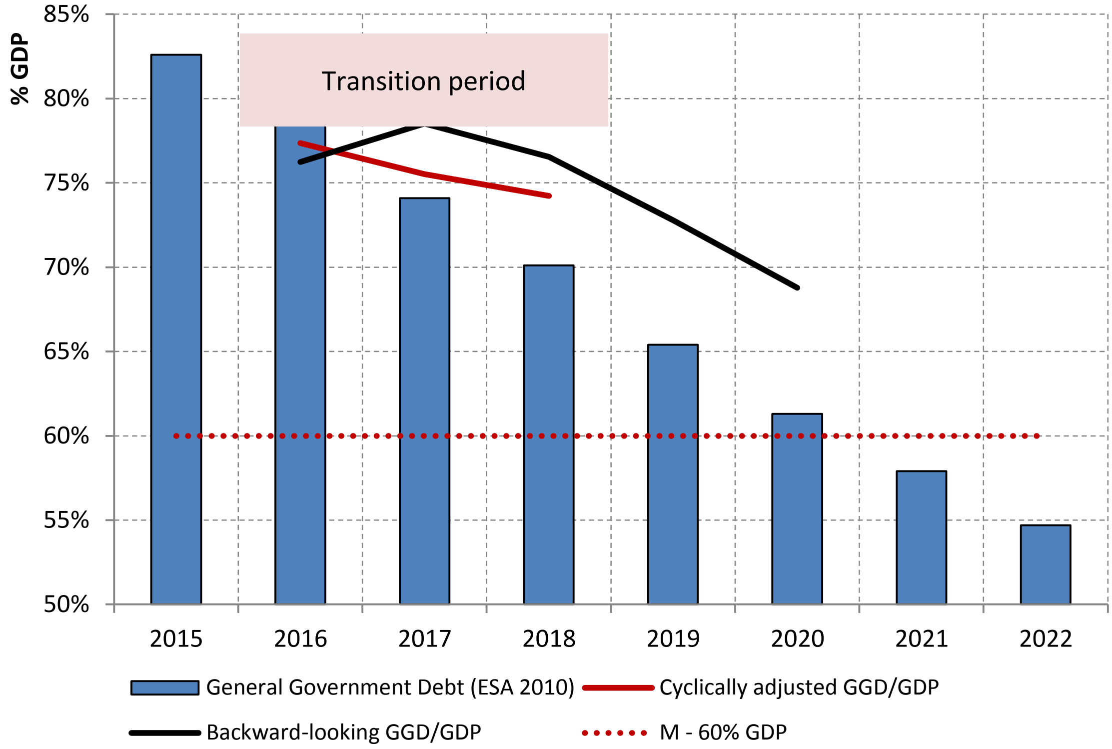
Member states, which exit excessive deficit procedure, need to comply with the diminishing debt rule, which states that a member state is non-compliant with the debt requirement, if its general government debt is greater than 60% of GDP and is not sufficiently diminishing and approaching 60% of GDP at a satisfactory pace. The concepts of "sufficiently diminishing" and the "satisfactory pace" are defined in Regulation 1467/97 as being fulfilled, if the differential of the debt with respect to the reference value has decreased over the previous three years at an average rate of 1/20th per year as a benchmark. The Regulation then specifies three conditions under the Debt rule relating to various different benchmarks: backward-looking measure; forward-looking measure and cyclically adjusted debt to GDP ratio.

Since the Republic of Slovenia exited EU excessive deficit procedure in 2015 with a deficit of 2.9% and with a peak of general government debt at 82.6% of GDP, it now needs to comply with the EU rules tackling excessive debt procedure.

The Republic complied with the debt rule from 2016 on since the forecasted debt ratio in 2018 was below the forward-looking debt benchmark. Forward-looking benchmark uses forecasts made by the Euroepan Commission on the basis of unchanged policies. In the transition period 2016-2018 from 2017 on both the actual and cyclically adjusted debt ratios comply with the backward looking benchmark. The conclusion is that the Republic of Slovenia successfully ended the transition period 2016-2018 in respect to special Debt rule transitional arrangements.

As it is shown below the Republic continues to be compliant with the Stability and Growth pact debt rule after transitional arrangements in the period above the 60% Maastricht criterion.

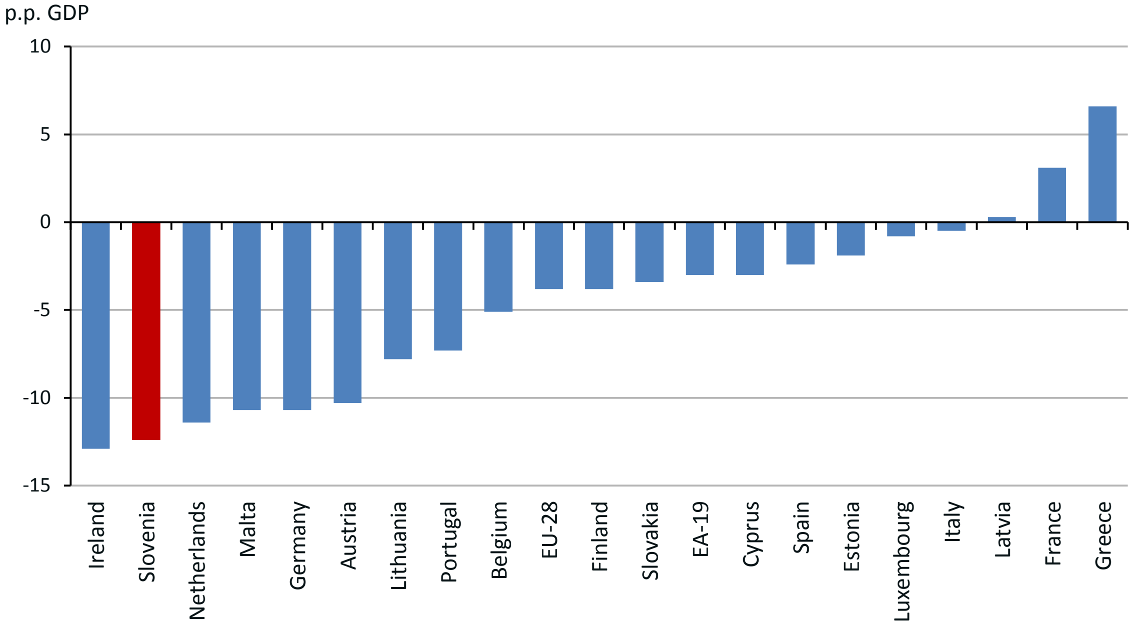
Figure 22: General government debt development from the SGP Debt rule perspective



Source: Ministry of Finance, Treasury Directorate

The figure below shows that, in terms of speed of reducing general government debt-to-GDP ratio, Slovenia is ranked second among euro area countries (only behind Ireland), with its debt-to-GDP ratio having declined from 82.6% GDP in 2015 to estimated 70.2% GDP in 2018 according to EC AMECO database.

Figure 23: General government debt dynamics in EA-19 in the period 2015–E2018

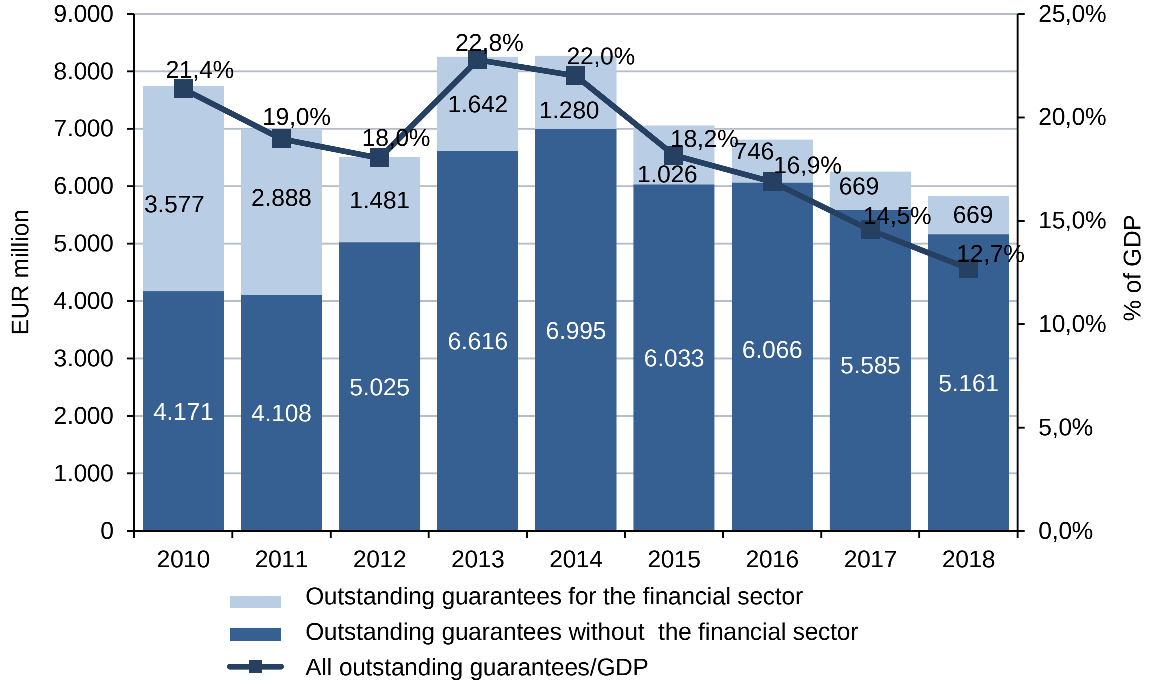


Source: Eurostat for 2015, EC AMECO database for 2018, 27.3.2019

- <u>Guarantees</u>

According to the constitution, the issuing of Republic of Slovenia guarantees is possible only on the basis of a law. Two types of guarantee laws have been developed within the system of issuing Republic of Slovenia guarantees. General guarantee laws regulate the issuing of guarantees to a wide range of recipients (e.g. the Act Governing Rescue and Restructuring Aid for Companies and Cooperatives in Difficulty). Specific guarantee laws are intended for precisely defined recipients (e.g. the guarantee laws governing the liabilities of Družba za avtoceste v Republiki Sloveniji d.d. (Motorway Company of the Republic of Slovenia), guarantee law governing the liabilities of Slovenski državni holding d.d. (Slovenian Sovereign Holding), etc.). The Republic of Slovenia can issue government guarantees to entities in both the public and private sectors. Private sector guarantees were primarily issued to companies in difficulty. These guarantees are also characterised by a relatively high level of redemption, while guarantees issued to persons in the public sector are not redeemed. The issuance of Republic of Slovenia guarantees is governed by the provisions in the systemic law, and the annual quota for the issuance of government guarantees is determined in the applicable law governing the implementation of the budget, whereby the government can also issue guarantees outside the quota if an individual law so allows. Republic of Slovenia guarantees amounted to EUR 5,831 million as at 31 December 2018, of which government guarantees for liabilities of the financial sector (S 12) accounted for EUR 669 million.

Figure 24: Republic of Slovenia guarantees 2010-2018



Source: Ministry of Finance

The data show the estimated end-of-year values of Republic of Slovenia guarantees, derived using certain assumptions regarding the payment of existing and approval of new guarantees. The planned quota for new guarantees for 2019, pursuant to the Budget Implementation Act, amounts to EUR 500 million and, separately for guarantees of SID banka d.d., EUR 350 million. The results from past years indicate that the level of exploitation of the quota is low, as it stood at 5.7% in 2015 and 14.8% in 2016. In the last two years the quota has not been reached, as all guarantees issued in 2017 were issued for the refinancing of existing liabilities, and no government guarantees were issued in 2018. The quota allocated for SID banka d.d. was also not used.

Table 10: Republic of Slovenia guarantees 2019-2022

	Balance as of 31/12/2019*		Balance as of 31/12/2020*		Balance as of 31/12/2021*		Balance as of 31/12/2022*	
	in EUR million	as % of GDP	in EUR million	as % of GDP	in EUR million	as % of GDP	in EUR million	as % of GDP
Guarantees of the Republic of Slovenia	5.379	11.0	5.033	9.8	4.660	8.6	4.194	7.7
including: financial sector*	669	1.4	669	1.3	669	1.2	669	1.2

Note: *In accordance with the Statistical Classification for Institutional Sectors (SCIS), all legal persons with an SCIS designation of S 12 are included.

Source: Ministry of Finance

EUR 0.5 million were spent on the redemption of Republic of Slovenia guarantees under the Act on the Guarantee Scheme for Natural Persons and the Act Governing Rescue and Restructuring Aid for Companies in Difficulty in 2017, while in 2018 there were no redemptions. The use of funds amounting to EUR 3 million is forecast for 2019.

4. FISCAL RISK AND SENSITIVITY ANALYSIS

The risks of lower economic growth than that forecasted in the basic scenario are associated with risks in the global and Euro area, which have slightly increased since last year's forecasts.

The main negative risks from the international environment are associated with uncertainty regarding the outcome of the negotiations over and the time of Brexit, the continued use of protectionist measures by the USA and its trading partners, more rapid than expected tightening of financing conditions on global markets, political uncertainty in certain EU countries and a high level of uncertainty regarding the measures to be taken by future administrations of the EU member states.

The factors in the domestic environment are mainly positive and could result in slightly higher economic growth than forecast in the basic scenario, particularly higher private consumption in the event of the adoption of economic policy measures (e.g. regarding pensions, wages or tax policy) that would result in increased growth in household disposable income (IMAD, 2019). There are also certain risks of a specific nature, which are discussed in detail in the following section.

The realisation of risks from the international environment would result primarily in lower economic growth and thus lower fiscal revenue, while the realisation of certain risks of a specific nature in the domestic environment would primarily increase government expenditure (particularly in the form of individual one-off expenditures). Potential changes to the nominal GDP growth rate and changes to the interest rate from the original forecasts are analysed in detail in sections 4.2 and 4.3.

4.1 Risks for the fiscal forecast

The table below gives a detailed overview of the key negative risks that could threaten the fiscal objectives in the short term, an assessment of the probability of the realisation of risks and the potential impact on public finances.

Table 11: Matrix of assessment of negative risks for the realisation of fiscal objectives

Risk	Probability	Effect	Potential financial consequences
International environment			
Uncertainty regarding outcome of negotiations over and time of Brexit; protectionist measures of the USA	Medium	Indirect negative consequences for Slovenian economy and exports, potential impact on public finances due to payments to EU budget.	
Political uncertainty and European elections	Medium	Uncertainty regarding political agenda of future administrations of EU Member States.	
Consequences of changes to ECB monetary policy and changes to financing conditions.	Low / Medium	The raising of the ECB's reference interest rate would have negative consequences for economic growth and management of general government debt in Slovenia.	Impact of the changed interest rate on the general government debt in section 4.3.

(table countinues)

(countinued)

Domestic environment			
Forecasts of drawdown of EU funds	Medium	Deviations from forecasts directly affect revenue and expenditure. Lower turnover reduces pressure on upper limit for expenditure, while in the coming years increases pressures to lower national expenditure, such that only these will remain within the adopted Framework.	
Natural disasters	Low	Increased government expenditure.	A budgetary reserve has been created for such purposes that operates as the Budgetary Fund.
Relaxing of limits to compensation amounts for erased from the register of permanent residents	Medium	Increased government expenditure.	The financial effects depend on individual legally recognised damages and default interest. Therefore a precise estimate cannot be given at this time.
Enforcement of final judgements regarding transferred foreign currency deposits of LB in Croatia	Medium	In this case the negative financial consequences for NLB will be offset by the Slovenian Succession Fund (the Fund). Governed by the Act Regulating Protection of the Value of the Financial Assets of the Republic of Slovenia in Nova Ljubljanska banka d.d., Ljubljana (ZVKNNLB), adopted on 19 July 2018.	The assessment of the financial consequences is uncertain, since it is not clear to what extent forcible recovery proceedings will be conducted on the basis of the final enforceable rulings of the courts of the Republic of Croatia regarding the ransferred foreign currency deposits.
Potential payment of compensation to former holders of qualified bank credit by the Bank of Slovenia	Low	If the court finds that the former holders are due compensation, it will be paid by the Bank of Slovenia up to the amount of the provisions created for that purpose and from general reserves (Act on Judicial Relief Granted to Former Holders of Qualified Bank Credit, adopted by the government on 9 April 2019).	At this time it is not possible to give a more precise numerical estimate of funds for the national budget.

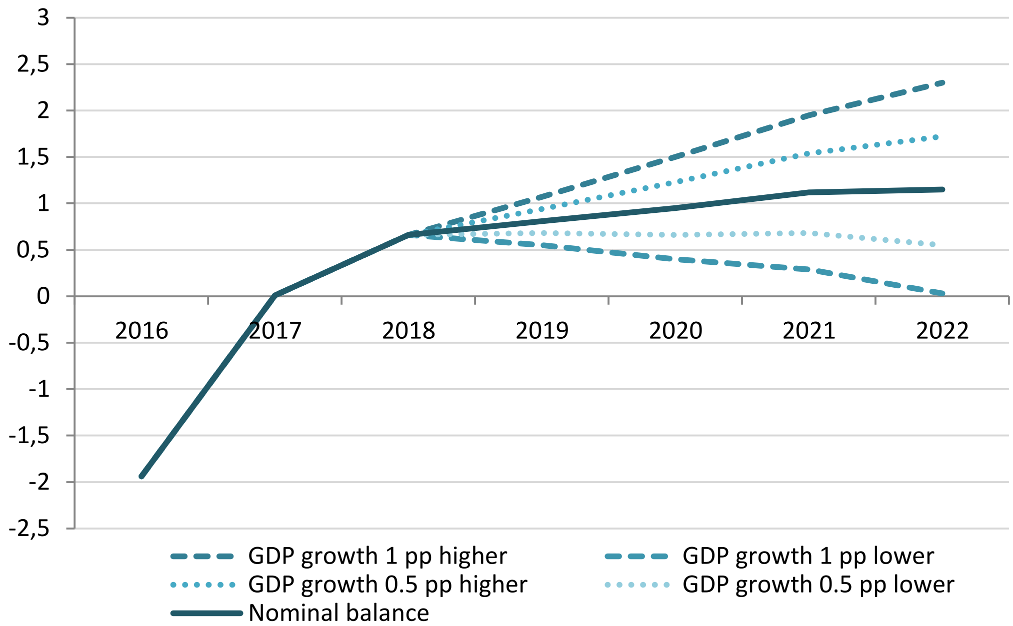
4.2. Analysis of sensitivity of general government balance to changes in GDP

The sensitivity analysis demonstrates that the fluctuation of economic growth affects the general government balance. Two alternative scenarios are assumed. In the first scenario, growth of the nominal GDP of plus or minus 0.5 percentage points is forecasted for the period 2019-2022 relative to the original forecasts (used in the 2019 Stability Programme) at an annual level linearly for all years. In the second scenario, nominal growth of plus or minus 1 percentage point is assumed.

In the case of 0.5 percentage points higher nominal growth of GDP than predicted, assuming a no-policy-change scenario, the general government balance would improve by 0.13 p.p. in 2019 and thus amount to 0.94% of GDP, and 1.72% of GDP in 2022. In the opposite case it would decrease by 0.13 p.p. and amount to 0.68% of GDP. A surplus of 0.55% of GDP would still be recorded in 2022.

In the second case of growth of 1 percentage point the forecasted surplus in 2019 would be improved by 0.26 percentage points, and would reach 1.07% of GDP. Thus with the aforementioned assumptions a surplus of 2.3% of GDP would be recorded in 2022. In the opposite case of nominal growth of 1 percentage point lower, the surplus in 2022 would be lower by 1.12 percentage points and would be close to balance. The deviations increase year-on-year, which is partly a consequence of the impact of the shock in the previous year.

Figure 25: Sensitivity of the general government balance to GDP developments in percentage points[14]



Source: Ministry of Finance

4.3. Sensitivity analysis of the debt service

The level of borrowing costs and costs of servicing existing debt in the future is expected to be mainly influenced by ECB monetary policy through the quantitative easing program (PSPP), the level of ECB main refinancing operations fixed rate (0%), which is expected to stay such by the end of the year 2019, and deficit volumes of the state budget. In the sensitivity analysis we assume that the ECB will keep the interest rate at the current level in the near future, followed by a gradual increase. The impact of the term structure of interest rates is already embedded in

[14] The revenue analysis was conducted on the basis of econometric calculations. For revenue we assumed that only expenditure for unemployment would change due to the shock (automatic stabiliser). The change is reflected in a -0.04 percent sensitivity of general government expenditure to changes in GDP developments, which is summarised according to OECD studies. The deflator is the same as in the original forecast.

the baseline scenario and additionally increased by 0.5 percentage points in the sensitivity analysis.

In case that the interest rate for the central government debt increases by 0.5 percentage points in 2019, this leads to an increase of costs of new borrowing by 0.0165 percentage points of GDP in 2020 and 0.0294 percentage points of GDP in 2021. In this case the state budget debt would increase by 0.0174 percentage points in 2019, 0.0310 percentage points in 2020 and 0.0523 percentage points in 2021. In case that the government deficit increases by 1 percentage point in 2019, the interest costs as a percentage of GDP would increase by 0.0112 percentage points in 2020 and 0.0106 percentage points in 2021.

Table 12: Sensitivity of interest payments and debt repayments of the state budget (in % of GDP)

	Change in interest rate		Change in deficit		Change in interest rate and deficit	
	Interest	Debt	Interest	Debt	Interest	Debt
Year	In percentage points					
2019	0.0000	0.0174	0.0000	1.0000	0.0000	1.0174
2020	0.0165	0.0310	0.0112	0.9461	0.0277	0.9771
2021	0.0294	0.0523	0.0106	0.8963	0.0400	0.9486
2022	0.0498	0.0608	0.0101	0.8527	0.0599	0.9135

Source: Ministry of finance, Treasury directorate.

In October 2012, May 2013 and February 2014 Republic of Slovenia issued all togehter 9.25 billions US dollar bonds while at the same time executing USD-EUR cross currency swaps to fully hedge (i.e. for interest and principal repayments) against the exchange rate risk. Since 2016 the Ministry of Finance has carried out liability management transactions of buying back US dollars bonds (i. e. 55,1 % of the total USD debt portfolio exposure). Simultaneously, cheaper euro bonds were issued to facilitate buybacks with a significant interest savings for the state budget and ultimately with the overall positive net present value of the carried out transactions.

The impact of change in the floating interest rate to the existing state budget debt, expressed as a percentage of GDP, is insignificant as the bulk of government debt has fixed interest rate, thus the change in interest rate affects primarily new borrowing. The share of debt with fixed interest rate is estimated at 99.1 % in 2019.

4.4. Long-term fiscal sustainability

Demographic projections are a key element of future development and long-term fiscal sustainability, as well as structural challenges. According to the demographic projections (ESSPOS2015), the structure of the population will change considerably in the future. The share of children and youth (0-19) will remain nearly unchanged, while the share of elderly (65 or older) will increase by more than half from 2016 to 2070. The share of the elderly will increase due to the higher number of people in the generation born in the years after the Second World War (the baby boomers) up to 1980 (when the birth rate was still high), and due to the rapid increase in life expectancy. The proportion of the working age population (20-64) will drop by around 17%. The old-age dependency ratio (P65+/P20–64), which indicates the ratio between dependent and working age population, will therefore double, from 30% to 60% by 2060. After 2060, the demographic pressure will slightly decline, as this ratio will fall to 55% by 2070.

In addition to demographic pressures, the increase in ageing-related expenditure is also affected by low projections of activity and employment rates of the elderly, which are among the lowest in the EU. Slovenia is also characterised by a low average age of leaving the workforce. The extension of life expectancy therefore also extends the duration of the retirement period, which is a key factor of the high expenditure, expressed as a percentage of GDP (taking account of the provisions of the existing pension system). According to the projections, in comparison with other countries, the duration of the retirement period in Slovenia is expected to be among the longest.

The table below shows the long-term projections of general governemnt revenue and expenditure to 2070, with 2016 as the base year. Eurostat's population projections and the European Commission's long-term macroeconomic assumptions and projections for the labour market,[15] which were used in the drafting of the new 2018 Ageing Report.[16] IMAD's projections (spring 2019) are used for the short term to 2022.

The long term age-related expenditure projections are similar with the projections in the 2018 Ageing Report. The smaller share of expenditure as a percentage of GDP related with pensions in the initial and medium-term period is primarily the consequence of the improved situation in the initial year in comparison to that used in the 2018 Ageing Report. In the structure of age-related expenditure, the largest share is expenditure related with the pension system, which is projected to increase by 4 p.p. in Slovenia from 2016 to 2070. Public expenditure on healthcare and education are also projected to increase more than the EU average, while the share of expenditure for long-term care is expected to increase slightly less than the EU average. In addition to demographic factors, growth in expenditure for healthcare and long-term care is also affected by non-demographic factors. In addition to GDP growth per capita and the increase of relative prices, they are affected in particular by technological progress and the increasing demand for high-quality healthcare and long-term care. Pressures on public expenditure for education in the 2016-2070 period are also expected due to demographic reasons. An increased number of enrolments in education is assumed, and expenditure is expected to increase at all levels of education.

[15] EC (2017), The 2018 Ageing Report, Underlying Assumptions & Projection Methodologies, Institutional Paper 065, November 2017, https://ec.europa.eu/info/sites/info/files/economy-finance/ip065_en.pdf.
[16] EC (2018), 2018 Ageing Report.

Table 13: Long-term fiscal sustainability (base year 2016)

v % BDP	2016	2020	2030	2040	2050	2060	2070	Razlika 2070 -2016
Total general government expenditure	40.9	39.4	42.1	47.2	53.9	59.3	64.5	23.6
Total age-related expenditure	21.7	21.3	23.6	26.5	28.8	28.9	28.3	6.6
Pensions	10.8	10.1	11.5	13.9	15.4	15.2	14.8	4.0
Old-age and early pensions	8.2	7.8	9.0	10.9	12.2	11.9	11.8	3.6
Disability pensions	1.3	1.1	1.3	1.5	1.7	1.6	1.5	0.2
Other pensions	1.3	1.2	1.2	1.4	1.6	1.6	1.5	0.2
Health care	5.6	5.9	6.4	6.8	6.9	6.9	6.7	1.1
Long-term care	0.9	1.0	1.2	1.5	1.8	1.9	1.9	1.0
Education	4.0	4.0	4.2	4.1	4.5	4.7	4.6	0.6
Unemployment	0.4	0.3	0.3	0.3	0.2	0.2	0.3	-0.1
Wage compensations	0.4	0.3	0.3	0.2	0.2	0.2	0.2	-0.2
Subsidies	1.0	1.0	1.0	1.0	1.0	1.0	1.0	0.0
State investments	2.4	2.4	2.4	2.4	2.4	2.4	2.4	0.0
Total primary expenditure	38.2	37.4	39.6	42.7	45.3	45.4	44.8	6.6
Interest expenditure	2.7	2.0	2.5	4.5	8.6	14.0	19.7	17.0
Total general government revenue	39.3	38.7	38.4	37.9	37.5	37.6	37.5	-1.7
Assumptions								
Labour productivity growth	1.3	4.0	2.1	1.9	1.8	1.7	1.5	0.3
Real GDP growth	2.50	3.73	1.58	1.28	1.25	1.61	1.45	-1.05
Real GDP growth per inhabitant	2.40	3.73	1.58	1.28	1.25	1.61	1.45	-0.95
Male activity rate (20-64 years)	79.3	81.3	81.3	80.4	81.4	82.1	81.4	2.1
Female activity rate (20-64 years)	72.2	75.5	77.5	76.7	77.7	78.2	77.4	5.2
Total activity rate (20-64 years)	76.1	78.5	79.5	78.6	79.6	80.2	79.4	3.3
Unemployment rate	9.0	6.7	5.9	5.9	5.9	5.9	5.9	-3.2
Share of population aged 65 years or more	18.2	20.7	25.2	28.3	30.6	30.2	28.5	10.3

Source: Ministry of Finance, Institute of Economic Research, 2018 Ageing Report

On the basis of estimates of age-related expenditure the European Commission calculated new indicators of fiscal sustainability,[17] which are an important element for the calculation of the new medium-term fiscal objective (MTO) to 2022. For Slovenia, the indicators have improved in comparison with the previous estimate, which ranks us among countries with medium fiscal sustainability risk in the medium and long term. Indicator S1, for medium-term sustainability, fell in comparison with the previous period (2015-2019) from 3 to 0.2 for the 2020-2022 period, and indicator S2, which measures long-term fiscal sustainability, fell from 6.8 to 5.5.

[17] The indicators of fiscal sustainability S0, S1 and S2 indicate the extent to which policy adjustments (fiscal and structural) are required now and in the future in order to achieve fiscal sustainability. Indicators S1 and S2, which measure the required adjustment of the general government primary balance with a given fiscal benchmark and required adjustments due to the costs of ageing, are particularly important. The indicators of fiscal sustainability are published in the 2018 Fiscal Sustainability Report.

The results of the projections clearly indicate a need for additional structural reforms that will improve the existing pension insurance, healthcare and long-term care systems and make adjustments to the education and training system, otherwise the age-related expenditure will increasingly quickly crowded out expenditures for other purposes in the future.

Slovenia addresses the issue of a long-lived society in the Strategy for a Long-Lived Society. It is designed based on the concept of active ageing, which emphasises activity and creativity during all periods of life, care for health and intergenerational cooperation and solidarity. The strategy comprises four pillars with guidelines for action (employment/activity; independent, healthy and safe life for all generations; inclusion in society; and creating an environment for lifelong physical activity). An Active Ageing and Intergenerational Cooperation Council has been established in order to monitor the planning and implementation of measures. The council is in charge of coordinating the operations of all stakeholders in this area.

5. QUALITY OF PUBLIC FINANCES and EFFECT OF STRUCTURAL REFORMS

In 2020, owing to the need for compliance with both the fiscal criterion, EC calculations and compliance with the EC (which has calculated a different distance from the medium-term objective in 2018 and 2019), Slovenia will apply for a use of a flexibility clause. The application will be submitted as soon as the final text is known. The text will be harmonised as broadly as possible with the Economic and Social Council and the general public, the individual laws and in particular with the eventual financial and fiscal effects (not so much in the short term, but primarily in the long term).

The flexibility clause and structural reforms

Member States are eligible to apply for the use of a flexibility clause if they adopt and implement the agreed structural reforms. This clause allows a temporary deviation from the achievement of the medium-term objective. The deviation may not lead to exceeding the deficit ceeling of 3% of GDP, while during the time of the assessment of the application for the use of a flexibility clause a safety margin associated with 3% of GDP must be provided. A temporary deviation is also permitted in year t+1 after year t, when the application for the clause was submitted. The maximum allowable deviation is 0.5% of GDP. The upper limit is required due to the uncertainty of the estimates of the costs and benefits of the structural reforms. The maximum initial difference between the structural balance and the MTO is 1.5% of GDP in year t. The difference can be achieved through maximum annual adjustments of 0.5% of GDP in the t to t+3 period. Member States are allowed to deviate from the MTO for three years. To a member state only one flexibility clause is allowed in the medium-term cycle (MTO). As structural measures are considered already adopted reforms, and also measures for which the timelines for their adoption are defined in detail (Vade mecum on the Stability and Growth Pact, 2019).

The proposed measures in the area of the pension system, which are currently being discussed with social partners, would affect the appropriateness of the level of pensions, increase the labour participation rate of older people and contribute to long-term sustainability of public finances. A gradual increase of the pension's accrual rate is planned, and thereby the provision of higher pensions to new pensioners. The accrual rate for 40 years of pensionable service would be 63% for both sexes. The increase would ensure a higher old-age, widow's, disability and family pensions and higher compensation from disability insurance. These changes would support the possibility of extending people's working lives. According to the proposal, individuals who would remain employed after meeting the requirements for a old-age retirement would in the period of three years besides compensation for work receive 50% of his/her pension; after that period, if a person would be aged 63 years or more, would besides compensation for work receive 100% of his/her pension. The extension of working lives would also be supported through a gradual increase in the retirement age, provisionally to 67 years by 2034. This measure would be intended for people who do not have 40 years of pensionable service when they reach age 65. Changing the method of adjusting pensions has also being studied.

The proposed measures on the labour market that are being duscussed among social partners relate to changes in the area of unemployment insurance (planned amendment to the Labour Market Act). An increase in the minimum unemployment wage compensation is proposed, so that it would be equal to the minimum income of a single person based on social legislation. On the other hand, the system would be made slightly tighter, where the new longest period of unemployment wage compensation would be reduced from 25 months to 19 months. The measure would thus mostly affect the labour participation rate of older people. The requirement for receiving the compensation would be increased from 9 months to 12 months of insurance in the last 24 months. Measures are also aimed at more effective sanctioning of refusal to participate in active employment policy programmes. The measures would result in increased activation of unemployed people and consequently on increased efficiency of public finances.

The planned amendments to the Social Assistance Benefits Act would separate the labour participation bonus from financia social assistance. Through this we anticipate a reduction in funds for the socially disadvantaged. Beneficiaries of financial social assistance who would lose their entitlements through this amendment would also no longer be eligible to coverage of part of the value of the healthcare services, which would have a further beneficial affect on public finances. Furthermore, initiatives would be introduced for the activation of unemployed beneficiaries for financial social assistance excluding revenue from measures for employment and employment rehabilitation of disabled people. This is intended to provide for the faster activation of beneficiaries of financial social assistance. By eliminating the labour participation bonus the trap of the inactivity of beneficiaries of financial social assistance would be reduced also. With the exclusion of revenue from active employment policy and employment rehabilitation measures according to the regulations on employment rehabilitation and employment of disabled people also the burden on the social services centres would be eased.

6. APPENDICES

Table 1.a: Economic growth and related indicators

	Rate of change in %	**ESA Code**	**2018 level**	**2018**	**2019**	**2020**	**2021**	**2022**
			million EUR					
1.	*Real GDP*	B 1 g		4.5	3.4	3.1	2.8	2.7
2.	*Nominal GDP*	B 1 g	45,948	6.9	6.2	5.7	5.6	5.1
	Real GDP components							
3.	*Private consumption*	P3	23,360	2.2	2.9	2.4	2.2	2.2
4.	*Government consumption*	P3	8,189	2.6	2.2	1.9	1.4	1.4
5.	*Gross fixed capital formation*	P51	9,060	10.6	7.7	7.0	7.0	7.0
6.	*Changes in inventories and net acquisitions of valuables (% of GDP)*	P52+ P53	984	2.1	2.2	2.0	2.0	1.9
7.	*Exports of goods and services*	P6	39,151	7.2	5.1	5.3	4.7	4.6
8.	*Imports of goods and services*	P7	34,796	7.7	6.0	5.8	5.4	5.4
	Contribution to real GDP growth (in percentage points)							
9.	*Domestic consumption*		41,593	4.2	3.5	3.0	2.9	2.9
10.	*including: Changes in inventories and net acquisitions of valuables*	P52+ P53	984	0.6	0.1	0.0	0.0	0.0
11.	External balance of goods and services	B11	4,355	0.3	-0.1	0.1	-0.1	-0.2

Source: SURS, Spring Forecast 2019, IMAD.

Table 1.b: Price developments

	Rate of change in %	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
1.	GDP deflator	2.3	2.7	2.5	2.6	2.4	2.3
2.	Private consumption deflator	2.4	2.1	2.1	2.3	2.2	2.1
3.	Consumer Price Index / HICP (average of the year)	1.7	1.6	1.9	2.2	2.2	2.2
4.	Public consumption deflator	1.9	4.0	4.0	4.0	3.2	3.3
5.	Gross fixed capital formation deflator	2.9	3.0	2.8	2.5	2.2	2.2
6.	Export price deflator (goods and services)	2.5	1.8	1.7	1.5	1.5	1.3
7.	Import price deflator (goods and services)	2.7	1.6	1.7	1.4	1.4	1.3

Source: SURS, Spring Forecast 2019, IMAD.

Table 1.c: Labour market developments

		2018 level	**2018**	**2019**	**2020**	**2021**	**2022**
		in 000					
1.	Employment (number of employed)[1], growth in %	1,017	3.0	2.0	1.0	0.6	0.4
2.	Employment, hours worked, growth in %	1,630,546	1.5	1.0	0.6	0.4	0.2
3.	Unemployment rate according to labour force survey, in %	53	5.1	4.3	3.9	3.7	3.4
4.	Labour productivity[2] (per employee), growth in %	45,2	1.4	1.4	2.1	2.2	2.3
5.	Compensation of employees[3], in EUR million, growth in % (D.1)	22,803	7.5	7.5	6.7	6.3	5.6
6.	Compensation per employee[3, 4], growth in %	22.416	4.4	5.4	5.6	5.7	5.2

Notes: [1] Employed population, national accounts definition (domestic concept), [2] Real GDP is taken into account, [3] Nominal growth, [4] Full-time employees are taken into account. Source: SURS, Spring Forecast 2019, IMAD.

Table 1.d: Sectoral balances

% of GDP	**ESA code**	**2018**	**2019**	**2020**	**2021**	**2022**
Net lending/borrowing	B.9 (S.1)	6.8	N/A	N/A	N/A	N/A
of which:						
Import and export balance of goods and services	B.11	9.5	9.1	8.8	8.5	N/A
Balance of primary incomes and current transfers	B.12	-2.2	N/A	N/A	N/A	N/A
Capital account	D.9 (rec-pay)	-0.4	N/A	N/A	N/A	N/A
Net lending/borrowing of the private sector	B.9 (S.1-S.13)	6.1	N/A	N/A	N/A	N/A
Net lending/borrowing of the general government	B.9 (S.13)	0.7	0.9	1.0	1.1	1.2
Statistical discrepancy		N/A	N/A	N/A	N/A	N/A

Source: SURS, Ministry of Finance, Spring Forecast 2019, IMAD.

Table 2.a: General government budgetary prospects

		ESA Code	Level 2018	2018	2019	2020	2021	2022
			million EUR			% of GDP		
			Net lending/borrowing (EDP B.9) by subsector					
1.	General government	S.13	336.6	0.73	0.95	0.95	1.12	1.15
2.	Central government	S.1311	391.9	0.85	0.88	0.89	1.05	1.08
3.	State government	S.1312	…	…	…	…	…	…
4.	Local government	S.1313	-63.1	-0.14	0.03	0.10	0.10	0.10
5.	Social security funds	S.1314	7.9	0.02	0.03	-0.03	-0.03	-0.03
			Total general government (S.13)					
6.	Total general government revenue	TR	19,800.4	43.09	43.18	42.59	41.82	41.35
7.	Total general government expenditure	TE	19,463.8	42.36	42.24	41.64	40.70	40.19
8.	Net lending/net borrowing	EDP B.9	336.6	0.73	0.95	0.95	1.12	1.15
9.	Interest expenditure	EDP D.41	910.5	1.98	1.63	1.47	1.31	1.16
10.	Primary balance		1,247.2	2.71	2.58	2.43	2.43	2.32
11.	One-off and other temporary measures		-47.7	-0.10	-0.09	-0.10	0.00	0.00
			Selected components of revenue					
12.	Total taxes (12a + 12b + 12c)		10,063.4	21.90	21.84	21.53	21.21	20.93
a.	Taxes on production and imports	D.2	6,464.5	14.07	14.00	13.67	13.37	13.08
b.	Current taxes on income and wealth	D.5	3,587.9	7.81	7.81	7.83	7.82	7.83
c.	Capital taxes	D.91	11.0	0.02	0.02	0.02	0.02	0.02
13.	Social security contributions	D.61	6,819.3	14.84	15.05	15.12	15.18	15.24
14.	Property income	D.4	509.4	1.11	0.93	0.71	0.65	0.60
15.	Other revenue		2,408.3	5.24	5.36	5.23	4.77	4.58
16.	16.=6. Total revenue	TR	19,800.4	43.09	43.18	42.59	41.82	41.35
	Tax burden (D.2+D.5+D.61+D.91–D.995)		16,880.9	36.74	36.88	36.64	36.39	36.17
			Selected components of expenditure					
17.	Compensation of employees and intermediate consumption	D.1+P.2	7,909.2	17.21	17.22	16.94	16.52	16.18
a.	Compensation of employees	D.1	5,022.1	10.93	11.21	11.09	10.89	10.72
b.	Intermediate consumption	P.2	2,887.1	6.28	6.01	5.85	5.62	5.46
18.	Social payments		7,592.7	16.52	16.31	16.15	16.10	16.12
	Of which: Unemployment benefits		160.4	0.35	0.32	0.23	0.25	0.27
a.	Social transfers in kind	D.6311. D.63121. D.63131	877.1	1.91	1.91	1.90	1.89	1.88
b.	Social transfers other than in kind	D.62	6,715.6	14.62	14.40	14.25	14.22	14.24
19.	19=9. Interest expenditure	D.41	910.5	1.98	1.63	1.47	1.31	1.16
20.	Subsidies	D.3	349.9	0.76	0.75	0.76	0.72	0.71
21.	Gross fixed capital formation	P.51	1,662.5	3.62	4.10	4.13	4.06	4.10
22.	Capital transfers, expenditure	D.9	192.9	0.42	0.42	0.44	0.32	0.28
23.	Other expenditure		846.1	1.85	1.81	1.75	1.67	1.64
24.	23.=7. TOTAL EXPENDITURE	TE	19,463.8	42.36	42.24	41.64	40.70	40.19

Source: SURS (Release on 19 April 2019), projections of Ministry of Finance.

Table 2.b: No-policy change projections

		ESA Code	2018 level	2018	2019	2020	2021	2022
			million EUR			*% of GDP*		
1.	Total revenue at unchanged policies	TR	19,800.4	43.09	43.18	42.59	41.82	41.35
2.	Total expenditure at unchanged policies	TE	19,463.8	42.36	42.24	41.89	40.95	40.44
3.	Net lending/borrowing	B.9	336.6	0.73	0.95	0.70	0.87	0.90

Source: SURS (Release on 19 April 2019), projections of Ministry of Finance.

Table 2.c: Amounts to be excluded from the expenditure benchmark

		2018 level	2018	2019	2020	2021	2022
		million EUR			*% of GDP*		
1.	Expenditure on EU programmes fully matched by EU funds revenue	610.55	1.33	1.88	2.13	1.63	1.40
a.	Of which investment expenditure fully matched by EU funds revenue	129	0.28	0.59	0.60	0.31	0.25
2.	Cyclical unemployment benefit expenditure	8	0.02	0.01	0.07	-0.03	-0.03
3.	Effect of discretionary revenue measures						
4.	Revenues increased mandated by law						
5.	One-off and other temporary measures	-47.7	-0.10	-0.09	-0.10	0.00	0.00

Source: Ministry of Finance.

Table 3: General government expenditure by function

	** before EDP notification*	COFOG code	2017	2017	2022
			million EUR	*% of GDP*	
1.	General public services	1	2,525.9	5.9	N/A
	including: Servicing of general government debt		*1,104.5*	*2.6*	N/A
2.	Defence	2	390.0	0.9	N/A
3.	Public order and safety	3	691.5	1.6	N/A
4.	Economic affairs	4	1,846.6	4.3	N/A
5.	Environmental protection	5	194.2	0.5	N/A
6.	Housing and community amenities	6	200.2	0.5	N/A
7.	Health	7	2,830.0	6.6	N/A
8.	Recreation, culture and religion	8	598.8	1.4	N/A
9.	Education	9	2,336.6	5.4	N/A
10.	Social protection	10	6,950.6	16.2	N/A
	TOTAL EXPENDITURE	**TE**	**18,564.3**	**43.2**	**N/A**

Source: *SURS.

Table 4: General government debt developments

	% of GDP	ESA Code	2018	2019	2020	2021	2022
1.	Gross debt		70.1	65.4	61.3	57.9	54.7
2.	Change in gross debt ratio		-3.9	-4.7	-4.1	-3.4	-3.2
3.	Primary balance		2.7	2.0	2.3	2.5	2.2
4.	Interest expenditure	EDP D.41	2.0	1.6	1.5	1.3	1.2
5.	Adjustments (SFA)		1.5	-0.3	0.3	1.0	0.6
6.	Implicit interest rate on debt		2.9	2.5	2.4	2.3	2.1

Source: Ministry of Finance.

Table 5: Cyclical developments

	% of GDP	ESA code	2018	2019	2020	2021	2022
1.	Real GDP growth (%)		4.5	3.4	3.1	2.8	2.7
2.	Net lending/borrowing of general government	B.9	0.7	0.9	1.0	1.1	1.2
3.	Interest expenditure	D.41	2.0	1.6	1.5	1.3	1.2
4.	One-off and other temporary measures		-0.10	-0.09	-0.10	0.0	0.0
5.	Potential GDP growth (%)		2.6	2.7	2.9	2.9	2.9
	Contributions:						
	- labour		0.1	0.2	0.3	0.3	0.1
	- capital		0.4	0.6	0.7	0.9	1.0
	- total factor productivity		2.0	1.9	1.9	1.8	1.7
6.	Output gap		1.7	2.4	2.6	2.5	2.3
7.	Cyclical budgetary component		0.8	1.2	1.2	1.2	1.1
8.	Cyclically adjusted balance (2–7)		-0.1	-0.2	-0.3	-0.1	0.1
9.	Changes in cyclically adjusted balance		-0.2	-0.1	-0.1	0.2	0.1
10.	Structural balance (8–4)		0.0	-0.1	-0.2	-0.1	0.1
11.	Fiscal effort in % of GDP		-0.2	-0.1	-0.1	0.1	0.1

Source: SURS, Ministry of Finance.

Table 6: Divergence from previous update

	% GDP	2018	2019	2020	2021	2022
1.	**Real GDP growth (%)**					
	2018 Stability Programme	5.1	3.8	3.2	3.0	3.0
	2019 Stability Programme	4.5	3.4	3.1	2.8	2.7
	Difference	-0.6	-0.4	-0.1	-0.2	-0.3
2.	**General government balance (% of GDP)**					
	2018 Stability Programme	0.4	0.2	0.6	0.9	
	2019 Stability Programme	0.7	0.9	1.0	1.1	1.2
	Difference	0.3	0.7	0.4	0.2	
3.	**General government gross debt (% of GDP)**					
	2018 Stability Programme	69.3	65.2	61.5	58.3	
	2019 Stability Programme	70.1	65.4	61.3	57.9	54.7
	Difference	0.8	0.2	-0.2	-0.4	

Source: IMAD, SURS and Ministry of Finance.

Table 7: Long-term sustainability of public finances (base year 2016)

% of GDP	**2016**	**2020**	**2030**	**2040**	**2050**	**2060**	**2070**	**Difference 2070-2016**
Total general government expenditure	40.9	39.4	42.1	47.2	53.9	59.3	64.5	23.6
Of which: age-related expenditures	21.7	21.3	23.6	26.5	28.8	28.9	28.3	6.6
Pension expenditure	10.8	10.1	11.5	13.9	15.4	15.2	14.8	4.0
Old-age and early pensions	8.2	7.8	9.0	10.9	12.2	11.9	11.8	3.6
Disability pensions	1.3	1.1	1.3	1.5	1.7	1.6	1.5	0.2
Other pensions	1.3	1.2	1.2	1.4	1.6	1.6	1.5	0.2
Health care	5.6	5.9	6.4	6.8	6.9	6.9	6.7	1.1
Long-term care	0.9	1.0	1.2	1.5	1.8	1.9	1.9	1.0
Education	4.0	4.0	4.2	4.1	4.5	4.7	4.6	0.6
Unemployment	0.4	0.3	0.3	0.3	0.2	0.2	0.3	-0.1
Wage compensations	0.4	0.3	0.3	0.2	0.2	0.2	0.2	-0.2
Subsidies	1.0	1.0	1.0	1.0	1.0	1.0	1.0	0.0
Government investments	2.4	2.4	2.4	2.4	2.4	2.4	2.4	0.0
Total primary expenditure	38.2	37.4	39.6	42.7	45.3	45.4	44.8	6.6
Interest expenditure	2.7	2.0	2.5	4.5	8.6	14.0	19.7	17.0
Total general government revenue	39.3	38.7	38.4	37.9	37.5	37.6	37.5	-1.7
Assumptions								
Labour productivity growth	1.3	4.0	2.1	1.9	1.8	1.7	1.5	0.3
Real GDP growth	2.50	3.73	1.58	1.28	1.25	1.61	1.45	-1.05
Real GDP growth per inhabitant	2.40	3.73	1.58	1.28	1.25	1.61	1.45	-0.95
Participation rate males (aged 20-64)	79.3	81.3	81.3	80.4	81.4	82.1	81.4	2.1
Participation rates females (aged 20-64)	72.2	75.5	77.5	76.7	77.7	78.2	77.4	5.2
Total participation rates (aged 20-64)	76.1	78.5	79.5	78.6	79.6	80.2	79.4	3.3
Unemployment rate	9.0	6.7	5.9	5.9	5.9	5.9	5.9	-3.2
Population aged 65+ over total population	18.2	20.7	25.2	28.3	30.6	30.2	28.5	10.3

Source: Ministry of Finance, Institute for Economic Research, 2018 Ageing Report.

Table 7.a: Projections of contingent liabilities of the Republic of Slovenia for the 2019–2022 Period

	Balance as of 31 Dec 2019*		**Balance as of 31 Dec 2020***		**Balance as of 31 Dec 2021***		**Balance as of 31 Dec 2022***	
	in EUR million	% of GDP	in EUR million	% of GDP	in EUR million	% of GDP	in EUR million	% of GDP
Public guarantees	5,379	11.0%	5,033	9.8%	4,660	8.6%	4,194	7.7%
Of which: linked to the financial sector*	669	1.4%	669	1.3%	669	1.2%	669	1.2%

Note: *According to the *Standard Classification of Industrial Sectors* this includes S 12.

Source: Ministry of Finance.

Table 8: Basic assumptions

	2018	2019	2020	2021
USD/EUR ratio (annual average) (euro area and ERM II members)[1]	1.181	1.135	1.134	1.134
Nominal effective exchange rate	0.7	-0.4	0.0	0.0
GDP growth in EU	1.9	1.3	1.5	1.4
Growth of export markets[2]	4.0	3.4	3.6	3.5
Oil price (Brent, USD/barrel)	71.0	63.2	62.6	61.4

Source: EIA, ECB, IMF, CME, forecasts UMAR. Notes: [1] For the years 2019-2021: Technical assumption based on the average exchange rate between 1. and 12. of February 2019; [2] Real import of goods and services, weighted by the shares of these countries in Slovenia's exports.